

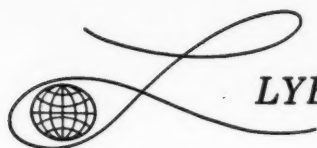
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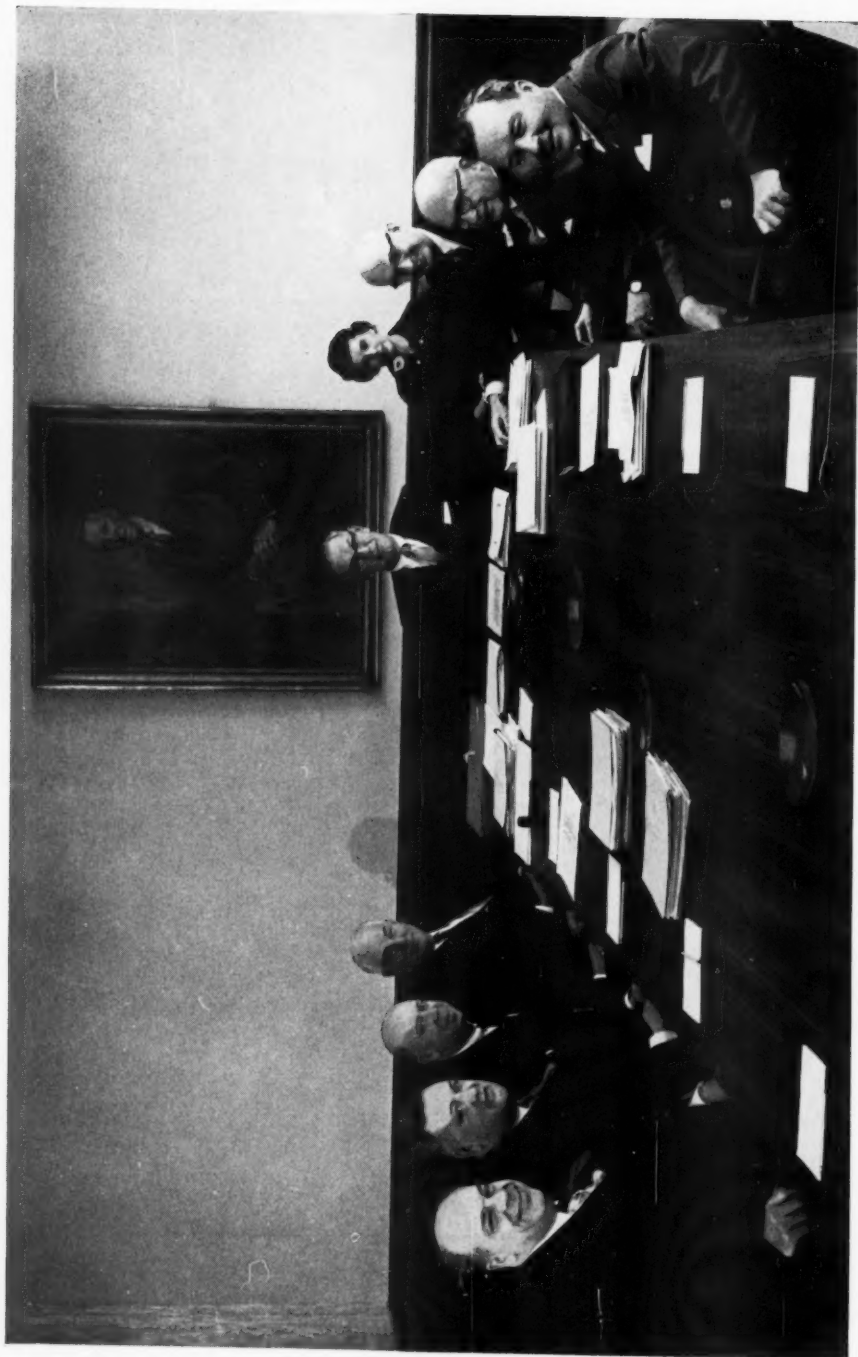
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A MEETING OF THE EXECUTIVE COMMITTEE IN THE NEW YORK OFFICE

Seated from left to right: HENRY C. ELFERS, WALTER R. STAUB, ROBERT S. WARNER, HILTON R. CAMPBELL, (Secretary to the Committee), ALVIN R. JENNINGS (Chairman), MRS. GERTRUDE GOEBEL (Secretarial Assistant), JAMES J. MAHON, GEORGE A. HEWITT, JOHN C. POTTER



The Future Role of the Accountant in Practice*

By Henry Benson

Introduction

I was brought up to believe that it was dangerous for a professional accountant to prophesy, particularly if he did so in a document which could become public property. I hope, therefore, that the Investigation Committee of the Institute will read this paper with an indulgent eye. Another disadvantage of prophecy is that one may have the humbling experience some years hence of looking back and realizing how grossly one misjudged the future. For both these reasons I would like to stress that the following thoughts are my personal views only, and in no sense do they represent the official views of the Institute or those of my partners and my Firm. Verily, I am also aware that no prophet is accepted in his own country. I should perhaps add however that I have been at pains to seek the views of a number of practicing accountants both in this country and abroad and I find that there is support for many of the views expressed in this paper.

The Origin of the Profession

Before gazing into the future to see what the role of the practicing accountant might be, I have thought it wise to spend a little time looking back over the past. The practice of an accountant as it exists today is comparatively recent. It is probable that accountants first began to practice on any scale in the City of London from about the year 1830 or 1840 and from that time forward until about 1880 the great bulk of their business was con-

* This paper was presented at the Autumn Meeting of the Institute of Chartered Accountants in England and Wales which was held at the Royal Festival Hall, London, on October 2, 1958. Minor changes of wording, which have been approved by the author, have been made in order to make the document suitable for publication in this JOURNAL.

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cerned only with bankruptcy, liquidations and receiverships. Indeed, Ernest Cooper, who was President of the Institute from 1899 to 1901, in writing of his recollections of the position when he first went to the City in 1864, wrote as follows:

We could hardly, South of the Tweed, claim to be a profession. There was absolutely no organisation or co-operation, no Institute or Society, no examinations, very few articled clerks, no newspaper, no library, no benevolent fund, and not even a dining club or golf club. Our social position was not enviable. We may disregard the then current gibes, that if an accountant were required he would be found at the bar of the nearest tavern to the Bankruptcy Court in Basinghall Street, and that an accountant was a man who had failed in everything else—for there was a goodly number of honourable men of standing and repute who followed our calling. But an accountant was regarded as associated with and dependent upon insolvency, and I well remember that to be seen talking to or having your office entered by an accountant, was to be avoided particularly in the stressful times of 1866.

The Bankruptcy Act of 1869 kept the accountants of those days busy but fourteen years later, in 1883, there followed the Bankruptcy Act which established, for the first time, the office of Official Receiver and this led to a great reduction in insolvency business for the professional accountant. In the meanwhile, however, the joint stock or limited company principle of business administration had been gaining ground. This provided an increasing volume of work for accountants and more than anything else helped to establish the position and strength of the profession. The joint stock movement was given impetus by the Companies Act of 1862 and then in 1879 and 1900 two further Acts were passed, the former requiring banks, and the latter every company to employ auditors.

During the last sixty years the profession has grown and flourished on the practice of auditing; until recently, by far the greater part of any accountant's business was concerned only with auditing and, in the smaller firms, in writing up books and preparing annual accounts for clients. In the last forty years there has been an increase in taxation work on behalf of private clients and limited companies, while more recently still the accountant has begun to be identified in the mind of the public with work in a number of other fields such as investigations of every description, organization, costing, management accounting, trustee work, secretarial and registration work.

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The Developing of Auditing

The present strength of the profession has therefore been founded upon the practice of auditing which has been undergoing continuous development since the beginning of the century and has been greatly helped by the Companies Acts of 1908, 1929 and 1948. Although there are many other services which an accountant can perform, I believe that auditing, and the accountancy work which goes with it in the smaller practices, will still provide for very many years to come the largest part of an accountant's practice. There are no figures available to prove it but I estimate that at present this type of work provides between 70 per cent and 80 per cent of the gross fees of an average business conducted by a practicing accountant.

There are some figures which may be of interest in this connection. The total number of companies on the registers in Great Britain at the beginning of the years shown was as follows:

| | <i>Number of Companies</i> | <i>Approximate Paid-up Capital £ Million</i> |
|----------------|------------------------------------|--|
| 1927 | 101,000 | 4,700 |
| 1937 | 148,588 | 5,800 |
| 1947 | 217,807 | 6,000 |
| 1957 | 306,610 | 7,000 |

The figures of paid-up capital shown above do not by any means reflect the real growth of the funds invested in these companies because they do not include the enormous sums representing share premiums, capital and revenue reserves. In the past thirty years the number of companies, all of which require auditors, has increased threefold. Approximately seventeen thousand new companies are registered every year and if deductions are made for companies which are dissolved or struck off, the net increase is about ten or eleven thousand per annum; in fact for the year 1957 the figures were somewhat in excess of those just given. Apart from limited companies, there is also of course a substantial volume of business in the shape of auditing and accountancy work for the nationalized industries, local authorities, clubs, societies, charities, sole traders and partnerships. Only about five thousand companies are quoted on the Stock Exchange, London, so that the overwhelming majority of the three hundred odd thousand

companies on the registers are private companies, or public companies only in the technical sense, as their shares are not quoted.

I see no reason why this growth in the number of limited companies should not continue. Looking forward over a period of twenty or thirty years, it seems to me inevitable that the great bulk of the work of a practicing accountant will still be in the role of auditor. That will continue to be the backbone of his business, and it will still provide the bulk of the practical experience which an articled clerk receives during his period of training. This is both a strength and weakness to the profession. Auditing provides a solid, steady and reliable business which gives security and stability to the practice of an accountant. Moreover, the basic training of an auditor establishes principles which can be applied with success in most forms of industrial and commercial enterprise. Nevertheless, there are weaknesses in this situation because an over-emphasis in auditing, which largely comprises checking the work of other people and is concerned with the past rather than the future, tends to narrow our point of view and dulls our sensibilities and does not always stimulate us to be imaginative and constructive.

The Basic Purpose of the Audit of the Future

Although auditing will provide us with the bulk of our work I would like now to take the first plunge into prophecy about the future and say that the profession's approach to auditing must undergo some radical changes in the next few years. Auditing at the present time is still too often based on the principle of examining the books and records as they are and checking or testing them to verify their accuracy. This is sought to be accomplished by varying degrees of routine work in the shape of vouching, the verification of additions and postings, and a concentration on arithmetical accuracy and the detection of minor frauds by the company's officials. It is still the belief of a large number of clients by whom we are employed that our main task is to verify that cash has not been stolen, that the books balance and are arithmetically correct and that the technical requirements of the Companies Act have been met. This attitude of mind both by the auditor and by the client is particularly manifest in some parts of the British Commonwealth. If we continue to approach an audit in this light, I do not think we shall continue to hold the respect of the business community. It is work of a routine char-

acter which is costly to the clients and achieves very little; clients will not be willing to continue to pay audit fees for this class of work or this type of approach.

The present and future approach of an auditor should, I think, be a different one. His task should be, firstly, to find out whether the accounts show a true and fair view and whether there has been disclosure of all the information which is necessary to enable shareholders (and in the case of quoted companies the investing public) to understand the company's position. Secondly, to prevent fraud or misrepresentation, though in this respect the character of the word "fraud" has changed in that the emphasis is not on the detection of defalcations by the company's officials but on fraud by misrepresentation in the annual accounts. Thirdly, to devote a large part of his work on the audit to the adequacy or otherwise of the company's system of internal check.

This approach to the audit is perhaps more manifest in the United States than it is here at the present time, and it is interesting to quote from the Codification of Statements on Auditing Procedure issued by the American Institute of Certified Public Accountants in 1951. The words in italics appear in that form in the original document.

The ordinary examination incident to the issuance of an opinion respecting financial statements is not designed *and cannot be relied upon* to disclose defalcations and other similar irregularities although their discovery frequently results. In a well-organized concern reliance for the detection of such irregularities is placed principally upon the maintenance of an adequate system of accounting records with appropriate internal control. If an auditor were to attempt to discover defalcations and similar irregularities he would have to extend his work to a point where its cost would be prohibitive. It is generally recognized that good internal control and surety bonds provide protection much more cheaply. On the basis of his examination by tests and checks, made in the light of his review and tests of the system of internal control, the auditor relies upon the integrity of the client's organization unless circumstances are such as to arouse his suspicion, in which case he must extend his procedure to determine whether or not such suspicions are justified.

At least one leading firm of accountants in America writes to its clients on acceptance of an audit making it clear that the audit is not designed, and cannot be relied upon to disclose defalcations and other similar irregularities. In this country too, some of the larger and more enlightened industrial companies have realized that it is a physical impossibility for the auditor to spend time in detecting minor defalcations and they would not seek to hold him liable for negligence if he failed to discover them.

I think it is the duty of the profession in the future to establish the principle that it is the task of management to install an adequate system of accounting and internal check to insure that the company's assets are properly safeguarded. This can be done by a properly designed accounting system, the use of mechanical aids, good administration, fidelity insurance, the careful allocation of duties among the staff and the prompt preparation of figures and statistics which highlight the important features of the business and show whether anything is going wrong. In the larger companies an internal audit department is often established which helps to carry out these functions. If the profession is successful in getting this principle firmly established it means that the external auditor will be free to devote the greater part of his time on the audit in finding out what the system of internal control is and making tests to see that it is functioning properly. He will be able to concentrate on discovering the weak spots and helping to correct them. These are skilled jobs which can only be carried out by experienced staff. It will be the auditor's task to report to the management if the system of internal control laid down is unsuitable or ineffective. In this way the auditor can show considerable initiative and play a much more constructive part than he does at present; he can be of real help to management.

Stock in Trade and Work in Progress

The next big change in audit practice must be in relation to stock in trade and, taken as a whole, I doubt whether our audit standards in this respect are high enough. For a long number of years too many of us have sheltered behind some of the passages in the judgment on the Kingston Cotton Mill case which was delivered in 1896, and quite insufficient attention has been given by auditors to the verification of the existence and the value of stock in trade and work in progress. Some auditors, even to this day, take no responsibility for stock and rely solely upon a certificate by the managing director. In my view this is indefensible and an auditor cannot properly sign the audit report required under the Ninth Schedule to the Companies Act if he has not taken proper steps to verify this asset.

The auditor's failure to ensure that stock and work in progress is properly taken and valued for the purpose of the annual accounts has in many instances caused this asset to be wrongly stated. Not infrequently this leads to inquiries by the Revenue

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authorities and to costly and troublesome back duty investigations. Very often, moreover, when a private business is ready for flotation as a public company, the examination of the profits for past years shows that stock has not been properly valued with the result either that the issue has to be postponed or the investigating accountant's report has to include a damaging qualification. At present the auditor may or may not have a legal responsibility when situations such as these arise, but whatever the legal position, he is certainly open to criticism in that he has failed to advise and guide his client wisely in matters which are essentially within his province as an auditor. The time will inevitably come in the next few years when the auditor's duties in relation to stocks are again tested in the Courts. When this happens it will be impossible for any member of the profession to come to the aid of a colleague whose defense is based primarily on the acceptance of a certificate given by the managing director as to the existence and value of stock in trade and work in progress.

In those cases in which auditors do verify stock and work in progress, I suggest that the tests normally applied in this country should go further than they do at present. I think that the auditors should watch the annual or periodical stock-taking made by the company's officials. This is one of the best means by which the auditor can satisfy himself as to the physical existence of the stock and it is an admirable means of testing the system of internal check under which the stock is taken; of ensuring that all stock is included; and of verifying that slow-moving obsolete and redundant stock is properly excluded or written down to marketable values. If, when it is done, this observation of stock-taking is done thoroughly, I do not think that it need be carried out every year and it would be adequate in normal cases to do it once every four or five years.

The Auditor's Functions in the Future

In 1953, the Institute of Chartered Accountants submitted a memorandum indicating the manner in which auditors could assist Parliament to exercise some supervision and control over the activities of the nationalized industries. This memorandum was published in the Report and Accounts of the Institute of 1953 at page 57. It has, so far, passed comparatively unnoticed, but if it is studied by the members of our profession, it will be seen that the conventional conception of an auditor's duties has changed.

The document should of course be read as a whole, but I set out below paragraph 8. Certain limitations in the terms of reference proposed in paragraph 8 were contained in paragraph 10 of the document, but for my present purpose I have not thought it necessary also to reproduce the latter paragraph.

The terms of reference might be as follows:

It shall be the duty of the auditor to submit, as soon as practicable after he has completed his normal audit report, a supplementary report upon any matter of a material or substantial character which may have arisen under the following headings even if already mentioned in the audit report:

(a) If, in matters of finance, the undertaking has not complied with the directives issued to it by the Minister, or other higher authority, to whom it is responsible, or with the provisions of the Act which controls or governs its existence. This section of the report should include appropriate comments as to the manner in which the undertaking has discharged its statutory duty to ensure that, taking one year with another, its revenues shall be not less than its revenue outgoings, and as to the amount and source of the funds available to meet the prescribed rates of interest on advances, if any, from the Consolidated Fund and to repay those advances within the prescribed period.

(b) If Government grants or subsidies have been given on the basis of estimates furnished by the undertaking and the subsequent results have differed materially from the estimates.

(c) If the accounts have not been drawn up so as to show clearly and fairly the results of the operations of the undertaking and, where appropriate, the effect of subsidies thereon.

(d) If, in the ordinary course of the audit, the auditor has formed the opinion that there is a *prima facie* case for further investigation into any of the following:

(i) Lack of proper administrative and financial control of revenue, expenditure (including purchasing procedures), assets and liabilities.

(ii) Substantial capital expenditure incurred which was intended to be productive but which had not proved productive or upon which an adequate return has not been received.

(iii) Expenditure incurred which is of an extravagant or wasteful nature judged by normal commercial practice and prudence.

(iv) Any other matters concerned with the financial administration of the undertaking which may be worthy of special comment.

In making his supplementary report the auditor will not normally, in the first instance, be expected to make exhaustive investigation of the foregoing matters. Any detailed inquiry and report required from the auditor would be a matter for subsequent specific instructions.

I do not think that the specific terms of reference given in that memorandum have, so far, been applied in their entirety to

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any nationalized industry but I know of one government department which has already gone some distance along that road as regards the undertakings under its care. The memorandum applied specifically to the nationalized industries, but it indicates a trend, which I am seeking to emphasize in this paper, of which we should all take cognizance. As time goes on I think that the public will feel the need for auditors who are prepared to express a view on the matters listed in the memorandum rather than on the routine and humdrum aspects of auditing to which we have devoted so much of our attention in the past.

If the changes in an auditor's work to which I have referred come to pass, it will mean a considerable change in an auditor's outlook and his approach to his work. It will no longer be possible to send staff 'round to clients' offices to take the books as they find them and apply such tests as appear to establish that the entries are correct. The audit staff will first have to find out all about the business of the company and whether the system of control and internal check, as laid down by the management, is adequate from the time that raw materials are first ordered until the finished product leaves the factory gate. When the partner attends the final discussion with the board of directors or the managing director before signing the accounts, he will be expected to point out weaknesses in the system of internal control, and to deal with matters such as the adequacy of the return on capital, the rate of stock turnover, the suitability of the costing system, improvements necessary in the system of stock-taking and stock control, wasteful expenditure, obvious weaknesses in administration and numerous similar subjects upon which he should be able to give helpful advice. This requires a much higher degree of skill on the part of the auditor and a wider knowledge of commercial, industrial and manufacturing processes. It must also cause us to wonder whether our present system of training articled clerks and newly-qualified members of the profession will have to undergo some alterations.

The Appointment of Auditors

Another change which I think may take place as regards the practice of auditing is the method by which the auditors are appointed. This is laid down in specific terms in the 1948 Companies Act, but it is thought by some that the Act gives perhaps too much protection to the auditor. It is important that it should

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be made difficult for unscrupulous directors to get rid of auditors who have done their duty, but on the other hand too great a security of tenure leads to complacency. I mention the point because it is a trend of thought of which we should take notice.

The Effect of Electronics on Auditing

Many of us are wondering what the effect of electronics will be on the methods of conducting an audit but it will be some years before this development can be seen in its right perspective. The installation of the machinery is expensive and much research and planning work has yet to be undertaken before electronics can be used for bookkeeping and accounting purposes except by large undertakings. If my conception of auditing of the future is the right one under existing conditions, it seems to me that it will be of even greater importance when books and accounts are re-recorded electronically, for the reason that there will be far fewer individual entries in the books physically to be seen or verified, and it will be all the more necessary for the auditors to concentrate on the system of internal control.

Other Types of Work

I have dealt with some of the changes which seem to me probable in our main business of auditing and I would now like to consider what other types of work are open to us and what changes may be expected in each of them.

Taxation

Although our profession has been built on auditing, taxation work has become of increasing importance in the last forty years. I suspect, from such discussion and enquiry as has been possible, that in terms of gross fees taxation work represents about ten to twenty per cent of the practice of an average accountant though I have no reliable statistics to support this belief.

I would like to digress for a moment at this point to say that comparatively few firms of accountants appear to analyze their gross fees as between the various classes of work or to ascertain the profit or loss on each job as it is completed or to find the proportion of the total profits which is derived from each class of work. I do not think that a professional accountant can run his business to the best advantage without this information; this comment lends point to some later observations I wish to make on the profession's attitude to costing generally.

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The complications of taxation are unlikely to diminish. Indeed, as far as limited companies are concerned, it is no longer possible to consider any proposal on any subject without first considering the taxation position, and in a great many cases, taxation considerations finally determine not only the form in which the transaction should be carried out but the nature of the transaction itself. The task of keeping up to date with legislation and case law decisions is a job for a specialist. It is scarcely possible for a professional accountant to give expert advice on taxation matters unless he spends the whole, or the greater part of his time on taxation work, keeping up to date not only with the theory but also with the many variations which are possible in practice. This means inevitably that in any practice, other than the smallest, it will be essential to have one or more taxation specialists who concentrate on this type of work. As the practice grows, these specialists will in time have to be split as between those who deal with the taxation of private individuals and those who deal with specialized problems of industrial and commercial companies. Many accountants organize their businesses on the principle that staff and partners should deal with all the various classes of work which the firm undertakes. I do not think that this system can survive. Taxation exemplifies more than anything else my belief that it is a task for a specialist and that unless an accountant in future organizes his business into specialist departments he will fail to give the best service to clients; this is one of the main themes of this paper.

Organization

There is another big field open to the professional accountant, almost unexplored, which I shall refer to by the all-embracing term of "Organization." I think that our forebears must have believed that sooner or later this would be one of the services which the professional accountant would perform because the word is shown prominently in one of the stained glass windows which adorn the stairs of our building in Moorgate Place.

Organization can cover many fields of activity but I use it specifically in relation to three things. Firstly, the physical methods by which financial transactions are recorded. Secondly, costing in its widest sense. Thirdly, the preparation and presentation of financial information to assist management and the administrative organization required to do this. Some or all of these

functions are often referred to in this country as management accounting; the term used in Canada and the United States, and one which is perhaps more likely to appeal to our clients, is "Management Services." I should like to emphasize that organization, in the sense in which I use it, is needed most in the smaller businesses for the reason that the big companies usually have the resources and facilities to administer themselves efficiently. Organization therefore opens a field for the member in practice who deals on the whole with the smaller rather than the larger company.

Dealing with the first of these phases of organization, there has been continuous and rapid growth in the manual and mechanical methods of recording financial transactions. It began in the dark ages with notches on stocks and it has progressed through the time when every item was laboriously written by hand. We have gone on, within the recollection of most of us here in this hall today, to typewriters, bookkeeping machines, filing systems, punched-card machinery and now to electronic accounting. It seems to me that the professional accountant should keep abreast of these developments and the office organization necessary to install them. Not only should he know the capacity and scope of these mechanical devices but also when it is or is not suitable and economic to install them. He should also be able to advise on the actual method of installation. A great deal of help is of course available from the manufacturers of the machines but there is a long process of preparation and planning followed by supervision of the operations in the early stages, and the professional accountant should equip himself to provide this service. Like all facets of an accountant's work it needs special study and specialized staff.

The second phase of organization work is costing. During the Second World War an enquiry was made by one of the Government departments into the type and efficiency of the costing methods employed in a very large cross-section of industry in this country. The results were a grave reflection on the accounts departments of British industry and the profession must share responsibility for that state of affairs. Many companies had no costing system worthy of the name; a majority did not reconcile their costing system with the financial accounts; large numbers had no proper control of the receipt and issue of stores; overhead rates, if used at all, remained unaltered for years. There has doubtless been an improvement since, but I suspect that even now the position is far from satisfactory. Indeed if each of us reviews his own clients

he will be forced to admit that many of them have indifferent costing systems which are capable of great improvement. If the professional accountant is to be able to fulfill the role which his clients will expect of him in the future I think that this is another type of work in which he should be expert. He should know from his experience as auditor of the business whether the costing system is adequate or not; he should be able to decide which form of mechanical system will give the necessary results; he should be able to make up his mind as to the form of costing information which will be most helpful to his client in running his business; finally he should, if asked to do so, be able to attend at his client's offices and supervise the installation of an adequate costing system.

The third phase of organization flows naturally from the first two. That is to say the preparation and presentation of budgets and financial information promptly and at regular intervals in order to assist management. A surprising number of businesses fail to equip themselves with the necessary tools of management. Voluminous statements and statistics are often prepared which either are not looked at or upon which no decisions are taken. On the other hand, management at all levels often does not furnish itself with, or interpret correctly, essential costing and other financial information without which it is impossible to run the business efficiently. The professional accountant's capacity to select the important from the unimportant and to interpret figures, coupled with his experience of the methods adopted in a number of other businesses, should make his advice especially valuable in this field. This is a much wider subject than the mere presentation of figures; it is usually necessary to begin by examining and changing the administrative organization, settling the channels of authority and pin-pointing the individual upon whom specified responsibilities must rest.

It may well be that, in advising clients under either or both of the two latter phases of organization work, the professional accountant will need technical help from engineers who are skilled in plant layout, work study, job progressing and similar matters. Insofar as the company itself cannot provide the necessary assistance, the professional accountant may wish to obtain the collaboration of one of the firms of consultants who provide this service. It would be unusual, though not unknown, for a professional accountant to employ engineers for this purpose.

I have stressed these three phases of organization because the

professional accountant is in danger of falling behind in each one of them. For example, the number of professional accountants who can devise a modern and efficient costing system is comparatively small; the number who is capable of attending at a client's office and supervising the installation is smaller still. Indeed, many of us, as I have pointed out, do not have an up-to-date costing system in our own businesses. The skills required to give competent professional advice on organization work take a long time to acquire. Much technical reading and practical experience is involved. I believe that in any practice of any size there is scope for one or more specialists who can study the various phases of organization work and advise clients on the needs of each particular business and the methods of installation. When the professional accountant is the auditor of a business I do not think that he should necessarily wait to be asked by his client for advice on these matters. As auditor he has a better opportunity than most people of knowing the weaknesses; if he feels that a client's business would be helped by a change of system or the installation of more up-to-date methods it is prudent and sensible to tell the client so. It will be seldom that the advice will not be welcomed.

Organization is a comparatively new subject which has only developed in recent years. It is not putting it too extravagantly to say that it offers the greatest opportunity and challenge to the professional accountant which has been open to him for the past fifty years. I think the professional accountant has failed to see or take the opportunities which are within his grasp in this field. If they are not seized now, it is certain that others will see them and wrest them from us. There are significant signs that this is already taking place.

Investigation Work and Special Studies

The public is only beginning to realize the value of an independent investigation and report by a professional accountant or the advantage of asking him to make a special study of a particular subject. The form such enquiries can take knows no bounds. The more usual forms cover such subjects as the examination of a new enterprise involving capital expenditures; an enquiry into the reasons why a business is not earning profits; a review of a company's internal administration and organization; a reorganization of capital; the cost of production of different products with a view to concentrating on the most profitable lines; share valuations; the

installation of a pension plan; the value of a business which is to be acquired or is to be the subject of amalgamation; or any one of a large variety of different subjects.

A professional accountant's capacity to find out the facts and present them fairly, to explode false arguments as the result of careful analysis, to suggest sound principles of administration, budgeting and finance, and generally to introduce a sense of realism into plans and forecasts, make his work in the investigation field invaluable. It is one of the most rewarding sides of an accountant's business and it is one of the roles of the accountant of the future which has the greatest scope. But it is not work which can be undertaken lightly. The expertise required to make the enquiry and present the result in a clear and balanced form takes a long time to acquire. Only experienced staff can be used and they cannot normally undertake other jobs at the same time because investigation work is too demanding in time and concentration. But there is another aspect which affects the accountant's approach to this type of work. Clients are not impressed by a report, however detailed or painstaking, unless it is concluded by a firm opinion.

I do not suggest that the accountant's traditional attitude of caution should change or that he should cease to be impartial. The point I am seeking to make is that if we are to be of real use to our clients, we must be prepared to give a common sense business judgment on the facts we have discovered. We must be prepared to say whether we think a new venture will succeed or not; whether the personnel are competent or incompetent; whether the administration of a business is sound or unsound; whether the estimates of capital expenditure are adequate or not. We are well suited to give these opinions as we usually have a better opportunity than most people of examining all the facts first; we are independent; and we have the advantage of drawing on a wide experience. The number of firms of accountants which at present does work of this nature is comparatively small but there is no reason why it should not be greatly extended. The business community is constantly seeking, and is having difficulty in finding, the advice and services of members of our profession who are prepared to undertake these responsibilities. It is a specialized work and a role we should be prepared to fill in the future.

Share Valuation Work

When dealing with investigation work, I pointed out that the professional accountant often has to undertake the valuation of shares of public and private companies when amalgamations or reorganizations take place, for the purpose of take-over bids and other acquisitions, and last but not least for estate duty purposes. The reason for singling it out for separate mention is that this type of work may grow considerably if a capital gains tax is imposed by the present or any future Government. I mentioned earlier that the total number of companies in the United Kingdom is over three hundred thousand of which only about five thousand are quoted on the Stock Exchange, London. If a capital gains tax is to be imposed, it may well be that all sales or transfers of shares in unquoted companies will involve valuations of shares at particular dates, so that the capital gain or loss can be measured. If such is the case, professional accountants may be employed in a large number of cases and it will be worthwhile, in many firms, to arrange for a partner and staff to specialize in this type of work. It is perhaps worth recording that a great many owners of shares in private companies do not know what their shares are worth; sometimes they greatly exaggerate the value of their holdings and at others they underestimate them. We can be of great help to our clients in advising them on this subject.

Estate Planning

There is scope in the field of estate planning for our clients and generally in executorship and trustee work. Where the professional accountant attends to the taxation affairs of a private individual he can and should, in conjunction with solicitors and counsel, advise him on the estate duty position and the advisability of making provision for himself and for children and dependents. In this way the professional accountant becomes familiar with the personal affairs of many of his clients who naturally often wish to appoint him as executor or trustee. The professional accountant is well fitted for appointment in this capacity as he can attend to the records and the preparation of annual accounts and other statements. I should say in this context, that very often the accounts and records maintained by private individuals who are appointed as executors and trustee, but are not professionally trained, are sadly deficient. Estate planning and trusteeships are types of work which can be developed but, like the related subject

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of taxation, they require specialized knowledge and continuous study of current legislation.

Bankruptcy and Liquidation

The amount of bankruptcy business available to the profession is comparatively small. With the steadily increasing use of limited companies, I do not think it will ever become a significant part of the work of a practicing accountant except for the few firms who specialize in it. The traditional business on which our profession was founded has therefore fallen to insignificant proportions.

On the other hand, the work of acting as liquidator of limited companies is likely to increase; I have already given some figures indicating the growth of the number of limited companies. At the present time six or seven thousand companies are struck off the register each year for one reason or another, most of which are formally put into liquidation. Like all other forms of professional work, there is an expertise in liquidations which can only be acquired by experience but the difference between a good liquidator and a bad one can make a considerable difference in the ultimate dividends paid to the creditors. In the larger firms, where one or two liquidations are always open, it is not unusual for the class of work to be dealt with by partners and staff who specialize in it.

Receiverships

We have not lived through a serious industrial depression in this country since 1930 and the depression before that was in 1921. Governments hope to avoid a repetition of those crises in which they may or may not prove to be successful. My personal conviction is that there will nevertheless be periods of depression, though perhaps not as severe as the two I have mentioned. When they come there will be a demand by bankers and the investment houses for receivers who can take control of concerns which have got into difficulties and perhaps bring them back to a prosperous future again. A good receiver needs much more than technical ability. He must have a commercial sense, the power to negotiate and the business judgment as to when a venture should be stopped or proceeded with. It is a service which we ought to be able to provide and we should be well advised to prepare for the demand which is bound to arise at some time in the next few years.

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While on the subject of receiverships, there is an aspect of it which warrants comment. Many receiverships and liquidations ought not to happen. The warning signs that trouble lies ahead appear usually months, if not years, beforehand and they should be more readily apparent to the auditor than to most people. The auditor of the future must be someone who is prepared to read the signs and warn the directors of the path they are treading so that they can take action in good time. It takes courage, but it typifies my conception of the professional accountant of the future.

Arbitrations

The professional accountant is sometimes appointed as arbitrator. In particular cases he is unquestionably the best person for the job and there always will be occasions in the future when his services are required in this way. This work is, however, of a casual nature and it is unlikely that it will ever be substantial. The courts are jealous of their responsibilities for settling disputes and, except in special cases, it is better that the normal processes of the law should be followed.

Registration Work

Some firms of accountants act as registrars of public companies which are quoted on the stock exchange. There is not a great deal of this type of work available as there is keen competition to secure it by both the banks and the issuing houses. In any case the number of companies with a quotation is not large and the volume of this work will therefore probably always be small and concentrated in the hands of a few firms.

Expert Witness

The professional accountant is sometimes called upon to act as an expert witness in arbitrations, valuation tribunals or on legal actions in the courts. It is exacting work and it requires immense preparation. Very often, moreover, a great deal of time has to be wasted in attending the hearing and listening to evidence which is irrelevant to the particular issues upon which the accountant has to give testimony. The volume of this type of work rises and falls for political rather than commercial reasons. Nationalization legislation after the Second World War with the consequent necessity of making valuations, created a special demand for the expert evidence of accountants but, for the time

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being, the demand has slackened. Political changes, in particular the inquiries now being instituted under the Restrictive Trade Practices Act, may bring about a recrudescence in the future.

The Accountant as General Adviser

I have dealt with all those classes of work which are now open to us or which will, I think, be open to us in the future and the lines on which they may possibly develop. There is one additional service which the professional accountant performs and which, I hope, he will continue to provide for the future. That is to act as friend, adviser, and confidant to his clients. Times without number clients feel the need not of technical advice on accountancy matters, but of discussion with somebody whom they can trust who will give them detached and common-sense advice. It may be on personal affairs, trends of economic or political thought and the probable effects thereof upon the clients' business, problems of personnel and human relations, or a host of other diverse questions. There may be little chargeable time in providing this service but it is one of the most satisfying tasks which the professional accountant can perform.

The Growth of the Profession

I had hoped to be able to present to you some statistics showing the growth of our profession in the past thirty years, and a comparison of the rate of growth with other professions, as this would enable one to make some intelligent guesses about the future. In fact it has proved impossible to do this, either because the necessary figures were not available from the many sources from which they had to be obtained or because they were not available on a comparable basis. It is a subject which would be worth further study in itself but this is not the occasion on which to pursue it.

The result of such inquiries as I did make, however, can be summarized as follows. In 1940 the total membership of all the accountancy bodies in the United Kingdom was approximately 34,000. In 1950 it had risen to approximately 40,000, of which 10,000 to 11,000 were known to be in practice. At the present time the total number is probably about 58,000 of which the number known to be in practice is probably just over 13,000. This is a considerable growth and we are now among the largest of the recognized professions in the United Kingdom. This rate

of growth cannot go on indefinitely but there is no sign at present of any slowing down. Indeed it is possible that, as a result of the recent scheme of integration of the Institute of Chartered Accountants and the Society of Incorporated Accountants, the rate of growth may be greater for a few years as the number of articulated clerks which members of the Institute can now accept has been increased from two to four in respect of each member in practice. More and more people are realizing the value of an accountancy training as a background for a commercial and industrial career and that will also tend to increase the numbers.

The Structure of Professional Firms

It seemed to me that it would be worthwhile to consider the structure of the profession. Here again comprehensive statistics are difficult to obtain but the following figures give some indication of the position; they relate only to the Institute of Chartered Accountants in England and Wales as it existed in 1957, shortly before the scheme of integration with the Society. At that time there were approximately seven thousand five hundred Chartered Accountants in practice and the number of firms was about three thousand five hundred. About two thousand out of the three thousand five hundred firms were sole practitioners and a further eight hundred firms had two partners only. In short, about one-half of the total members in practice were on their own account or were members of two-partner firms. Of the whole three thousand five hundred firms comparatively few are recognized as specializing in any particular class of business.

If you agree that there is scope for the professional accountant in the roles I have suggested it seems to me that there must be some important changes in the structure of the profession. The wide scope of an accountant's duties and the need for continuous specialized study of particular subjects if he is to give expert service to his clients means that either or, most probably, both of two things must happen. Either firms generally must be larger or else certain firms must specialize in particular classes of business. It will be increasingly difficult for one man practicing on his own account, or even for two men, to give a full and proper service to clients. Firms will therefore have to be increased in size so that partners can specialize and thereby provide the wide range of expert service which clients need. Apart from providing better and more expert service, all of us who have enjoyed the

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benefit of several partners know the value of discussion in settling difficult points and the benefit of being able to get different points of view at short notice by walking into other partners' rooms. Larger partnerships have other advantages. It is possible to employ a better balanced staff, partners can leave their business to take adequate holidays and continuity is assured in the event of illness. There is the further great advantage that the broader case of the practice gives a much better training ground for articled clerks. I think therefore that partnerships will tend to increase in size and every encouragement should be given to them to do so. A well-balanced firm might, I think, comprise not less than four partners which would enable all of them to deal with a certain amount of auditing and accounting work and yet enable particular partners to specialize in the other classes of work. There will, of course, always be work for small firms of accountants dealing with sole traders and small undertakings, but if such firms wish to extend their practices into larger fields I believe that they can only do so effectively on the lines I have indicated.

The alternative is that some of the larger firms should specialize in particular classes of work and the smaller firms should send clients to them to get specialized advice on subjects which they cannot deal with properly themselves. This already happens to a certain extent and the tendency may increase. It is worthwhile bearing in mind the practice in the medical profession where the general practitioner sends his patients to specialists when their complaints need the advice of a physician or surgeon who has spent a lifetime studying that type of illness. In the same way solicitors send their clients to counsel who are known to specialize in particular subjects. The principle is no different in our own profession. It raises questions of professional ethics, however, which need handling with great care and are not appropriate to this paper.

The Need for Specialization

I do not know which of the two foregoing courses offers the most practical solution. The significant point remains that, in my view, there must be a much greater degree of specialization than has been the case in the past. The growth of the profession has been so rapid and the scope of the services it can offer to the public has been so much enlarged in the last few years that the need for a comprehensive plan to encourage specialization has been overlooked. It is partly due to the fact that the profession as a whole

is not administered centrally and there are the several different accountancy bodies within it. The recent integration with the Society which has increased the size of the Institute and extended its authority over a very large part of the profession may be helpful in bringing about some very necessary changes in this and other respects.

Education in the Profession

These thoughts lead me to wonder whether we shall not have to reconsider our present basis of training both for articled clerks and for qualified members. I have stressed the need for specialization in order to give proper service to clients but it is difficult for most members of our profession under present conditions to get both the theoretical knowledge and the practical experience to equip themselves with these skills. How then are we to ensure that, as a profession, we provide them for our members. Does it mean that the period under articles should be shortened and the time thereby saved should be spent under instruction in special subjects? Will it involve post-graduate course? Will the profession have to divide itself into specialist branches in the way that the medical profession has done? Are we giving the right training to the many accountants whom we know will leave the professional field after qualification and take appointments as accountants in industry and commerce? Shall we get the quality of articled clerks the profession needs unless we pay them properly? Are our educational standards high enough?

I do not propose to suggest the answers to these questions except to say with conviction that the present position is not satisfactory and to make the point that we shall not find the answers unless we begin to look for them. Now that the first period of reorganization and consolidation of the profession since the end of the war is over, and with integration an accomplished fact, I believe it is time we began to undertake long-term planning for the future. I believe that study groups should be set up to give thought to them and to other matters of a similar character which will shape our destinies during the next fifty years. They are among the biggest problems which face the accountant of the future and ones which we must begin to answer now as it is many years before an education program can bear fruit.

Most of us are already finding the need not only for more specialized staff but staff generally of a better quality who will be better paid. I think it also means that we must expect and

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demand a different, if not a higher, standard of education than we have been satisfied with hitherto. A very large number of newly-qualified chartered accountants are not capable of putting their thoughts clearly into words or of writing coherently. More and more the nature of our work will mean that we shall have to be able to express ourselves clearly in speech and in writing, and I doubt whether our present requirements from an education point of view are the right ones.

Provision of Capital

Another consequence of increased specialization and larger firms will be that firms will require more capital to run their businesses. Particularly is this so under inflationary conditions. I do not see how the professional accountant of the future is going to be able to accumulate the necessary capital because the burdens of taxation virtually prohibit savings except of a minor character. This is especially true during the time when capital is most needed by a professional man which is usually when he has children to educate at school or the university. I think therefore the time will come when professional firms will have to be permitted to operate as limited companies so that there will be some means of accumulating profits free of surtax, sufficient at least to provide the cash capital necessary to run their businesses. I am far from suggesting that the personal responsibility which is an integral part of professional life, should be removed. One of the things which keeps the profession healthy is the knowledge of its members that they are responsible for their advice and opinions up to the full extent of their assets, and I think this should be retained. It may be, therefore, that the form this change will take will be the formation of unlimited private companies. Alternatively, professional partnership firms may continue to exist for the purpose of accepting responsibility but the actual work may have to be subcontracted to limited companies of which the partners in the professional firms are the shareholders and directors. In either case the companies will, it is hoped, be able to accumulate profits necessary to provide working capital.

The Average Age of the Profession

I see another change in the future. In the past, owing to their inability to accumulate savings and the absence of any pension scheme, members of the profession have carried on until very late

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in life, far longer than executives in commerce and industry. They have done this, broadly speaking, because they could not afford to retire. Now that there are arrangements for pensions for self-employed people, it is possible, provided one starts young enough, to contemplate retiring on a reasonable pension about the age of sixty-five. This change should begin to make itself felt in the next twenty-five or thirty years as a result of which one may expect a reduction in the average age of practicing members. I believe that this will be a good thing. It will tend to give a more lively approach to professional matters and it will give greater opportunities to the article clerks of today and those who succeed them in the next few years. It is to be expected also that members will be elected to the District Societies or to the Council at a younger age than in the past and correspondingly that they will retire earlier, though it is to be hoped that a small number of elder statesmen will be retained on the Council.

Payments for Goodwill

If the various prophecies come to pass, I think another consequential result will be that the payment for goodwill for professional practices, and between incoming and outgoing partners in a firm, will come to an end. It will be difficult enough, even if the formation of limited or unlimited companies is permitted to find enough cash capital with which to run a professional accountant's business. Young incoming partners will not have the means or the earnings to pay for goodwill and the outgoing partners, instead of relying in part on the goodwill payment for their retirement, as they have done to some extent in the past, will in future have their pensions to live on. The practice of paying for goodwill has, in any case, been declining for some years past. I think it will stop altogether in the next ten or fifteen years and for the good health of the profession it is desirable that it should be so.

The Professional Accountant's Influence in the Future

The professional accountant collectively and individually wields a considerable influence. The views we express publicly or in the course of our work, our conduct as members of a profession and the advice we give to the many people who seek it have, over the years, a profound effect on public and company administration, the form and substance of documents presented to the public,

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financial transactions of all descriptions and indirectly, if not directly, on some changes in the law. Our role in this respect is unlikely to diminish and the more we equip ourselves to undertake the types of work I have described, the greater will that influence become. There are one or two directions in which I think our influence should be exerted at once.

Accounting under Inflationary Conditions

We have an immediate task to lead the way in finding sensible methods of accounting and of financial administration under inflationary conditions. In short, inflation is here and in most overseas countries as a permanent evil and nothing short of an international trade recession is likely to stop it. We should remember that if the pound is deemed to have been worth 20s. in 1946, it has dropped successively in the intervening years until at the present time it is worth about 12s. only. Comparatively little has, so far, been done in the accounts of public companies to calculate what the effect of inflation has been and to provide for it out of profits so as to ensure (quite apart from expansion and development) that the business is maintained and that its capital is not diminished. Some efforts have been made by the more farsighted industrialists to take steps to provide for this deterioration in their resources year by year as it arises but, generally speaking, the lead has come from commerce and industry and not from the profession. We have a real opportunity for leadership here as our numerous clients cover the whole field of British industry.

This leads to the consideration of another aspect of inflation which is the professional accountant's influence in relation to prospectuses. The statutory, and indeed the traditional approach, is for the accountant to certify the profits for a number of past years, usually ten, but is sometimes more and sometimes less. I believe that under inflationary conditions those profits, without an explanatory statement, have only a limited value because a thousand pounds earned ten years ago is not the same as a thousand pounds earned now. It can be argued that the general effects of inflation are so well known as not to require further emphasis but I doubt whether this is so. I believe that it ought to be made clear in the body of the prospectus that, because of the effects of inflation, a mere statement of past profits is not a fair reflection of future earning capacity. In short, a trading business which

shows a steady profit for the past ten years is normally declining; it is holding its own only if the profits rise year by year in the same ratio as the £ is falling in value. In addition I think that the professional accountant has a role to play in regard to the replacement of capital assets. I suggest that he should not allow his name to be put on a prospectus unless the prospectus makes it clear what policy is to be adopted in order to provide for the increased cost of replacing capital assets over and above the depreciation which has been charged against the profits which have been the subject of certification. This can be done by presenting the estimate of future profits in a form which will indicate that, after paying the dividend which is forecast, they are adequate not only to provide for depreciation on the historical cost of fixed assets included in the statement of net assets but also on the basis of depreciation on the replacement cost of those assets at the time when the prospectus is issued; alternatively, if replacement at current prices is not to be made out of profits, the prospectus should indicate the sources from which it is expected that the additional capital will be provided. This is not a role which falls only on the professional accountant; it affects issuing houses, solicitors, directors and others, but the professional accountant can play a significant part in it and his influence would do more than anything else to bring about an improvement in the existing position.

Information for the Investing Public

Another way in which professional accountants can exercise their influence in the future is in advising the boards of companies what information they should give to their shareholders and, as regards companies which have a quotation, the investing public, over and above the statutory accounts for which they are responsible as auditors. Here again I believe that British industry is falling somewhat behind the rest of the world and that we, as accountants, have our part to play. It used to be claimed that information furnished to shareholders or the investing public only gave information to competitors. In the great majority of cases I believe this to be nonsense. The number of companies whose interests are harmed by disclosure of reasonable information about themselves, their activities and their results, is comparatively small. I believe that as professional accountants we should advise the boards of all companies that in addition to the statutory accounts, they should publish a summary of the results for the

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past ten years so that without unnecessary research and labour shareholders can watch the trend. I believe that whenever it is practicable to do so, figures of sales either in quantity or value, or both, should also be published. I think there should be a statement showing in a consistent form the earnings in relation to capital employed, and information showing what proportions of the net revenue of each year are retained for expansion or other purposes or distributed by way of dividend to the shareholders. Apart from providing this additional information, which is of real importance to shareholders, there is a great deal to be done in simplifying published accounts. The accounts of a great many public companies are confused by unnecessary detail and voluminous notes, much of which could be avoided. The professional accountant's influence in this direction could bring about a great improvement in a very short time.

But I do not think the professional accountant's advice to his clients should stop there. There is a growing anxiety on behalf of the investing public to know at shorter intervals than a year how companies are progressing. I think the professional accountant should meet this need and advise his clients on how much it is safe for them to publish, and the form in which the information should be presented, so that it will not be misleading but will still give an adequate indication to shareholders and investors how companies are faring during the course of the year.

Conclusion

What then in summary is the role of the practicing accountant of the future? He will of course continue to be a person of integrity and independence with a balanced judgment. I hope also that he will be a man of broad general education who can express himself clearly in speech and writing. The profession of which he is a member will have organized itself so that its members can receive the training and experience necessary to provide the specialist services which the public will expect and need in the future from accountants. He will have taken advantage of these facilities; he will become a member of a firm without paying for goodwill and will have three or more partners who collectively can give a proper service to clients in all phases of a professional accountant's work, particularly investigation and organization work. The audit practice of his firm will comprise perhaps no more than fifty per cent of the gross fees and will be conducted

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on the lines I have suggested earlier in this paper. He will be an employer, jointly with his partners, of a balanced staff the senior members of which will, like himself, have specialized training and knowledge. His firm will pay its articled clerks adequately and have a large enough practice to train them properly. The firm will finance itself in part in one or other of the ways I have indicated and its partners will retire at sixty-five on a reasonable pension. During his service in the profession he will be, above all, somebody who is constructive in all phases of his work; who is anxious to lead rather than to follow; to initiate rather than to check the work of others. We have a long way to go to equip ourselves in these ways but unless we do so we shall fail to keep pace with the needs of our clients.

The Years With Ross— T. E., CPA*

Pennsylvania's Governor Leader proclaimed Certified Public Accountants' Day when the Pennsylvania Institute, second only to New York in age, celebrated its sixtieth anniversary on March 19, 1957. The choice of speakers on such an occasion can be difficult, but in one case Chairman J. Woodrow Mathews had a natural.

T. Edward Ross might well be characterized as the memory of the accountancy profession in Pennsylvania. He is the author of *Pioneers of Organized Public Accountancy in Pennsylvania*, and has written biographical sketches of the founders of the Pennsylvania Association of Public Accountants. He himself was one of the founders back in 1897 when it was called the Pennsylvania Association of Public Accountants. This group brought about passage of the state accountancy law the following year, and the association's name became the Pennsylvania Institute of Certified Public Accountants.



T. EDWARD ROSS

Thomas Edward Ross was born in Northern Ireland on November 18, 1867. When he was five his family moved to Ontario where his father was a school principal. In 1885, the family became residents of the United States. After schooling in New Jersey, Mr. Ross joined his brother Adam who was employed by John Heins, a leading Philadelphia accountant. Other members of the same staff included William M. Lybrand and Robert H. Montgomery.

In 1892, Mr. Ross became a partner in the firm of Heins, Whelen, Lybrand & Co. On Mr. Whelen's withdrawal, the firm name was changed to Heins, Lybrand & Co. On January 1, 1898, William M. Lybrand, T. Edward Ross, Adam A. Ross, Jr. and

* Reprinted by permission from *The Journal of Accountancy*, December, 1959, p. 8.

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Robert H. Montgomery withdrew to begin practice under the firm name of Lybrand, Ross Bros. & Montgomery.

Like so many of the leading practitioners of accounting, Mr. Ross has continuously engaged in a wide variety of professional activities on both the state and national level. Besides being one of the fifteen charter members of the state organization, he has served at various times as secretary, vice president and president.

The American Institute has also been the fortunate beneficiary of the Ross energy, talents and guidance. He has been an active member for over half a century, and has served on more than a dozen of its most important committees, many times as chairman. He was vice president of the Institute in 1921, served on the executive committee for five years, and for ten years was a member of the Institute's Council.

Church and community work have also occupied a considerable part of his time. One of his hobbies is gardening and every year hundreds of people visit his extraordinary flower garden at his summer place in Craftsbury Common in Vermont. He is a golfer as well, and although it may not be a feat of note to play in the nineties, it is when the golfer in question is in *his* nineties.

The last time we saw him was on a visit to our former "Tax Clinic" editor, Jim Mahon, a partner of L.R.B. & M. then resident in Philadelphia. Mr. Ross was in a reminiscent mood and with a faraway look in eyes that retain an amazingly youthful sparkle, he told us of his first audit engagement. It went back over six decades. He was introduced to the client who took one look at him and snapped, "This man doesn't look old enough to be an auditor." If that client were alive today, he still might not think so.

Current Trends in Depreciation Accounting*

By Walter R. Staub

In the history of accounts and accounting, depreciation for a long time was given little recognition. At the turn of the century it was perhaps more often ignored than otherwise. Probably the first general acceptance of depreciation as an element of cost coincided with enactment of the income tax laws. Even then, the idea persisted in the minds of many that capital assets for all practical purposes might properly be considered as having unlimited existence. This was especially so in those segments of our economy which had large investments in fixed assets, composed of many units which were maintained and replaced with regularity so that the plant, as a whole, was preserved without loss of efficiency. In addition, there existed a not inconsiderable body which, while not necessarily contesting the validity of the general concept of depreciation, objected to its introduction into accounts on the grounds that too great an element of conjecture was involved. There were, of course, also differences of opinion as to the preferable method of its calculation; these, though were of secondary importance. In time, however, there was general agreement on the need for depreciation accounting and, within broad limits, on methods of its application.

The subject has, however, never ceased to be a matter of continuing interest to accountants, and within recent years considerable attention has been focused on the question of the adequacy of periodic depreciation charges as computed under present conventions. I am referring of course to the impact of present inflationary forces upon depreciation which is computed on the basis of historical costs that, because of inflation, are no longer representative of current costs. This aspect of depreciation accounting is of such great current interest that I want to devote what I am going to say to it and I believe that the increasing amount of attention given in recent years justifies its being considered as a trend in thinking—although there is no discernable trend toward actual adoption.

* This paper was presented before the regional conference of the Controllers Institute of America at Richmond, Va., and was published in a slightly condensed form in the October issue of *The Controller*.

Shortly after the close of World War II, business became concerned because costs of capital replacements far exceeded the original cost of assets replaced. In the then belief that these excess costs were occasioned by inflationary influences which might be expected to be temporary in nature, the belief arose that they should be charged off in the year of their occurrence; however, this idea never achieved acceptance to any degree—perhaps because of the objections of the accounting profession, but more likely because it was soon admitted that inflation was with us to stay.

The concern regarding the disparity between current and historical cost however persisted and has given rise to continuing questions as to whether depreciation charges based on historical dollar costs provide a realistic measure of the charge which need be made against income for the exhaustion of facilities in order to arrive at a useful concept of periodic net income. Those asking the questions and suggesting thoughtful alternatives include many leaders in the fields of business and accounting. In particular, they stress that profits as now reported are grossly overstated because generally accepted accounting principles do not recognize as an expense the difference between depreciation charges based on historical cost and the current cost of replacing obsolete plant. Maintenance of capital, considered in the sense of productive capacity, is placed in jeopardy. Taxes paid on this alleged overstatement of profits are viewed as capital levies. It has been argued that modernization and maintenance of plant has therefore been deterred which in turn has led to a deterioration of our country's competitive position in the world. While I feel the intensity of the attack has tended to vary somewhat with variations in the cost of living index, it now appears that many consider continuing inflation as inevitable. In their opinion, the long-term trend in the purchasing power of the dollar will continue to be in but one direction—down.

Those who are concerned with the consequences of adherence to historical cost depreciation believe that financial statements would be more useful if depreciation charges, and possibly the related fixed assets, were stated in terms of current valuations. They suggest that (1) investors require more information than accounting on a historical cost basis can provide (2) establishment of a dividend rate consistent with maintenance of capital on a purchasing power basis would be facilitated (3) in wage negoti-

ation, the company's ability to pay would be more fairly presented, and (4) in rate-making cases the utility's economic return would be more readily apparent.

They also point out that management should have available current costs on which to base its decisions. Since depreciation is often a significant part of product costs it is important that it be stated at current price levels. Such adjusted cost data are needed as an aid to management in setting product manufacturing and selling policies. This argument stresses the greater significance of current dollar costs as compared with costs arising from prior price levels.

There is no doubt as to the magnitude of the problem. Approximately 10% of the Gross National Product, or some \$40 billions of dollars, is currently being invested annually in new plant and equipment. A survey of some 750,000 corporate income tax returns filed for 1955 indicated that plant account represented the largest single investment of corporate funds—three times the investment in inventories.

The aggregate annual depreciation charge against income has been estimated to currently approximate 15 to 16 billion dollars. This total depreciation charge is expected to increase, reflecting continued plant expansion coupled with a trend toward greater mechanization and a speed-up in obsolescence resulting from technological improvements. The dollar amounts are huge when measured on a national scale and of relatively equal significance for many individual companies. Against this background of tremendous plant investment and related depreciation provision, we find a dramatic degree of inflation in the post-war period, as indicated by a 50% rise in the Consumers Price Index. It is this inflation which has led to our current depreciation controversy.

Since initial attention to this matter was occasioned by the fact that accumulated depreciation did not meet the cost of replacing depreciated facilities it was somewhat to be expected that first consideration would be along the lines of charges which accumulate amounts equal to such replacement costs. A survey by the American Institute of Certified Public Accountants in 1958 indicates that this is still the objective of many of those who question the adequacy of historical cost depreciation. However there is an increasing number who recognize that such replacement depreciation probably is an unreachable goal since continuing deterioration of the dollar creates continuing deficiencies that as a practical matter cannot be made up out of current revenues.

Those who do not hold for replacement depreciation but who, nonetheless, believe that historical cost depreciation is currently unsatisfactory, point to what they consider to be the internal inconsistency of financial statements which, in effect, reduce to a common denominator expired costs representing expenditures of differing purchasing power. They liken the problem to that encountered in the preparation of consolidated financial statements where different currencies are involved. They also point out that the same incongruity was recognized in the case of inventories but that it has in large measure been overcome by the adoption of the LIFO method of costing. They further conclude that since other material asset items are, by reason of turnover, reasonably expressed in terms of current dollars, the only remaining area in need of attention lies in fixed assets. These do not view departure from historical cost as a departure from cost, itself, but as being in the nature of a step to employ costs of like value. They believe there is no longer any validity in the accounting postulate that changes in the value of the monetary unit may be disregarded.

The foregoing statements briefly indicate the views of those who believe that a departure from depreciation based on historical cost is called for. I shall endeavor, with equal brevity, to state the feelings of those who hold to the opposing view.

First, let me say that, as far as I have been able to discern, all are in agreement that the changing value of our monetary unit affects the significance of historical cost depreciation, and that as a consequence, resultant net income must be considered in a different light than would be the case if a stable monetary unit had been our experience. Those who presently adhere to historical cost depreciation concede that under conditions of inflation depreciation accumulations are less a measure of the dollar cost of prospective replacements than if the monetary unit were stable, but they contend that replacement is not the intended purpose of depreciation provisions. They also consider that inflation has not yet proceeded to the point that original dollar costs have lost their significance. In general they believe that the adoption of adjusted depreciation methods gives rise to problems which call for further consideration and entails possible disadvantages and that these factors presently outweigh the merits of its use in basic financial statements.

This question has been the subject of intensive study by accountants since shortly after the close of World War II. In

1947 the Committee on Accounting Procedure of the American Institute of Certified Public Accountants issued a statement on the subject—Accounting Research Bulletin No. 33. This bulletin was reconsidered and, without change of substance, was reissued in 1953 as part of Accounting Research Bulletin No. 43. In addition, the Institute, with the aid of a grant from the Rockefeller Foundation, caused the organization of a study group on Business Income to consider the impact of inflation on business income. This group, after several years of study, caused its findings and conclusions to be published in 1952 in a monograph entitled "Changing Concepts of Business Income." Another well-recognized accounting organization, the American Accounting Association, also studied the question of the effect of inflation upon financial statements and issued a statement on the subject in 1951 which was repeated in 1957 in "Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements." Because the conclusions of these groups represent the considered opinions of informed and intelligent men who had carefully and thoroughly considered the problem, I believe it worthwhile to cite them:

COMMITTEE ON ACCOUNTING PROCEDURE OF THE AMERICAN
INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (1953):

The committee, therefore, reaffirms the opinion it expressed in Accounting Research Bulletin No. 33, December, 1947.

Any basic change in the accounting treatment of depreciation should await further study of the nature and concept of business income.

The immediate problem can and should be met by financial management. The committee recognizes that the common forms of financial statements may permit misunderstanding as to the amount which a corporation has available for distribution in the form of dividends, higher wages, or lower prices for the company's products. When prices have risen appreciably since original investments in plant and facilities were made, a substantial proportion of net income as currently reported must be reinvested in the business in order to maintain assets at the same level of productivity at the end of a year as at the beginning.

Stockholders, employees, and the general public should be informed that a business must be able to retain out of profits amounts sufficient to replace productive facilities at current prices if it is to stay in business. The committee therefore gives its full support to the use of supplementary financial schedules, explanations or footnotes by which management may explain the need for retention of earnings.

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STUDY GROUP SPONSORED BY THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (1952):

Upon this point it would seem that in the longer view methods could, and should, be developed whereby the framework of accounting would be expanded so that the results of activities, measured in units of equal purchasing power, and the effects of changes in value of the monetary unit would be reflected separately in an integrated presentation which would also produce statements of financial position more broadly meaningful than the orthodox balance sheet of today. It is believed that statements of business income in which revenues and charges against revenue would be stated in units of substantially the same purchasing power would be significant and useful for many of the purposes for which income determinations are commonly used, if not also in reports upon stewardship.

The problem of presenting both the most generally useful income determination and a fully significant statement of financial position would doubtless present difficulties, but probably none which the highly developed accounting techniques of today could not solve.

For the present, it may well be that the primary statements of income should continue to be made on bases now commonly accepted. But corporations whose ownership is widely distributed should be encouraged to furnish information that will facilitate the determination of income measured in units of approximately equal purchasing power, and to provide such information wherever it is practicable to do so as part of the material upon which the independent accountant expresses his opinion.

AMERICAN ACCOUNTING ASSOCIATION (1957):

Management may properly include in periodic reports to stockholders comprehensive supplementary statements which present the effects of the fluctuation in the value of the dollar upon net income and upon financial position.

(a) Such supplementary statements should be internally consistent; the income statement and the balance sheet should both be adjusted by the same procedures, so that the figures in such complementary statements are coordinate and have the same relative significance.

(b) Such supplementary statements should be reconciled in detail with the primary statements reflecting unadjusted original dollar costs, and should be regarded as an extension or elaboration of the primary statements rather than as a departure therefrom.

(c) Such supplementary statements should be accompanied by comments and explanations clearly setting forth the implications, uses, and limitations of the adjusted data.

On the one hand the proponents of adjusted depreciation do not deny the usefulness of the cost concept, given a reasonably stable monetary unit. On the other hand, those holding the opposite view nonetheless infer by their reasoning that under some

conditions they would deem adjustment of historical cost to be appropriate. It appears therefore that the difference in views is based largely upon varying weight given specific problems and consequences attendant upon use of current cost methods rather than to stem from any disagreement on a matter of broad principle. I therefore believe it important to consider each of these specific matters.

The need for restatement of assets: It is my impression that most of those who favor continuance of depreciation on the basis of historical cost appear to feel that if a change to a "current cost" basis were to be made, a concurrent restatement of the related asset accounts would be necessitated. At least some of those who advocate the adoption of current cost depreciation, believe that plant may continue to be carried in the balance sheet at historical cost with deduction of depreciation based thereon. In addition to historical depreciation, they propose a supplementary annual charge to income with a corresponding credit to an account for property replacements and substitutions, to be classified with the stockholders' equity. I cannot agree with the latter opinion. In the absence of related adjustment of the balance sheet, a discrepancy would arise between it and the income statement which would have the effect of relegating the balance sheet to a position of practically no importance. Also, since the significance of the income statement depends to a considerable extent upon viewing it in relation to the balance sheet this discrepancy would to a large extent, also tend to impair the usefulness of reported income.

Price indices: Many of the proponents of price-level adjustments suggest the use of indices to accomplish the purpose. This appears to be motivated both by reasons of practicality and from the belief that the use of indices contributes to objectivity and, assuming the adoption of the same or similar indices by companies, to greater comparability. Further they believe that it relates adjustments more to price level changes and less to reproductive costs of specific assets. While indices which are based on large aggregates may be an imperfect measure of change when applied to a specific group of assets I certainly would not object their use if it were to be decided to adopt current depreciation since the alternative would be periodic appraisals which, it appears to me, are impractical if adjustments are to be made at frequent intervals.

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Objectivity: Many who are opposed to price-level adjustments point to loss in objectivity in the determination of reported amounts. Undoubtedly there would be some loss of objectivity, since I can imagine no standard of accounting measurement which would be as objective as the actual cost resulting from an "arm's-length" transaction. However, objectivity in many aspects of accounting has been in the nature of a compromise with other considerations and, personally, I do not view this as an insurmountable objection. It seems to me that measures for adjustment could be evolved which would provide a reasonable degree of objectivity.

Uniformity in financial reporting: Over the years considerable progress has been achieved in developing greater uniformity and standardization in financial reporting. In the United States, fixed assets are stated at cost and depreciation is based on cost with but few exceptions. Any substantial change in the basic financial statements, unless generally adopted throughout the country, would likely lead to numerous diverse practices in statement presentation, with consequent confusion in their interpretation. For example, some companies would be likely to continue to show fixed assets at historical cost. Some other companies would probably establish valuations by use of specific indices while still others would use general price indices or perhaps a combination thereof. Aside from the confusion and possibility of misunderstanding which might be engendered by lack of uniformity in financial reporting, is the question of the impact of a change upon existing contracts. To cite only one example, in the case of a pre-existing bond indenture limiting dividends to accumulated earnings, which measure of determining income would be used?

Deflation: Many, both accountants and others, who believe that depreciation should give recognition to current price levels appear to be motivated by conservatism since they point to what they consider an existent inflation of profits. What will the position of these be in the event we come upon a period of deflation? Will that same conservatism allow them to accept a determination of income which would be predicated on less than historical cost? Would bondholders tolerate under conditions of deflation a determination of income that might be less protective than historical cost? I believe that this possibility should be very carefully considered before we espouse any general change to price level adjusted depreciation in the determination of income.

Maintenance of capital: Much of the argument in favor of current cost depreciation appears to be motivated by the feeling that real capital—i.e., the command over economic goods and services—is subject to possible erosion unless revenues are charged with current cost depreciation in the determination of income. There are two points which I would like to make on this aspect of the problem. First, since as I believe I have heretofore indicated, current cost depreciation does not provide for replacement, it may lessen but cannot eliminate erosion of the character contemplated. Second, does erosion occur to the extent that capital additions are financed by bonds or other types of fixed dollar securities? It has been said that the method of financing an asset is not relevant to the determination of how it should be depreciated. If this is so, what is our position to be when we deal with facilities whose use is obtained under long-term lease arrangements? These have been availed of to an increasing extent in recent years. An instance came to my attention recently where orders were placed by a company for certain units of equipment some of which were to be purchased and the use of others, identical in nature, was to be obtained by a long-term lease. Leases of this nature bestow upon the company employing a productive facility substantially all the benefits of ownership and entail substantially all the responsibilities of ownership. In my opinion, which is shared by others, these lease arrangements represent in substance a choice among various available forms of financing. If this be so would not the considerations which lead to the feel for need of adjustment of historical cost depreciation also call for some adjustment of charges under long-term leases? The economic value of a lease and the economic value of property owned are both the present worth of expected future utility. Expressed in dollars both are subject to the same fluctuations of our monetary unit. Yet I cannot envision why protection of proprietary capital would necessitate any adjustment of rental payments. Further, assuming deflation, a downward adjustment of rentals to me is unthinkable. I am led to the conclusion that the form of financing does exert some influence on the need for current cost depreciation.

Lifo: It has been stated that the adoption of the Lifo basis of costing inventories has resulted in the recognition of current inventory costs in the determination of income and that this also is the aim of the use of current cost depreciation. This statement

carries with it the suggestion that since the one has been considered acceptable, so should the other. I do not believe this argument has substantial merit. It seems to me that the advocated depreciation change involves a departure from historical cost whereas Lifo does not. As a consequence the problems entailed are of such difference in magnitude that the analogy is of little significance.

Summary: From all of what has been said and written on this matter of current cost depreciation, and which I have just endeavored briefly to cover, the following thoughts occur to me:

(a) There is general agreement that given a sufficient degree of inflation a basis of accounting other than historical cost would be generally needed, and hence acceptable.

(b) That there is equal disagreement on whether or not we have yet reached that point.

(c) That there are many questions of implementation and of consequences to the adoption of current cost depreciation to which further thought should be given.

Until we have arrived at more general acceptance of the need for recognizing price level changes in the determination of depreciation for purpose of a charge against revenues and until more of the related questions are resolved, it is my opinion that, for purposes of presenting the customary formal financial statements, we should adhere to the present concept of income based on historical cost.

In view of the divergencies of opinion on this subject I am in favor of the use, at present, of supplementary information along the lines suggested by the American Institute of Certified Public Accountants and the American Accounting Association. I believe that this supplementary information can be portrayed in various ways. One possible method which might be appropriate for some companies would be (a) to determine net income on the basis of historical cost depreciation, (b) to make an appropriation of net income for the amount by which depreciation based on current dollars exceeds depreciation on an historical cost basis, and (c) to credit the latter amount to an appropriately designated account in the equity section of the balance sheet. I am unable to see why the use of supplementary data would not accomplish the objective of those who now feel that basic statements do not furnish the information needed by interested readers under present conditions. It would further meet the desires of the not incon-

siderable body which believes that, on balance, conventional statements presently form the more useful basis for reporting corporate income. Possibly even more important, the use of supplementary information is feasible of immediate implementation.

In view of the many allegations concerning the deficiencies of our financial statements and the avowed needs of business for a means of recognizing the effects of inflation, I am considerably surprised that more companies have not availed themselves of the use of this supplementary media of explanation.

What I have just said leads me to wonder if business ever would really consider adoption of price level adjusted depreciation until such time as it became also acceptable for purpose of arriving at taxable income. There seems to be an analogy in the case of declining balance depreciation. This method has been acceptable to accountants for many years, yet its use in this country never became at all widespread until the enactment of the Internal Revenue Code of 1954. And, even now many companies which avail themselves of it for tax purposes, continue to report depreciation in their financial statements on the straight-line basis. Since here was a method which would in any event ameliorate the alleged deficiencies of historical cost depreciation, why has there not been more widespread use of it?

If tax considerations are an important point in the minds of many who advocate the adoption of current cost depreciation for use in the determination of net income, presumably the expectation is that such adoption might lead to some lightening of the corporate tax burden through allowance as a tax deduction of a greater amount of depreciation. It seems to me that this represents a somewhat superficial view of our tax problem which basically is the portion of our national income that is used to support government functions. If we assume that our over-all tax burden is to remain unchanged, any changes in corporate taxes by reason of a more favorable depreciation deduction would be only a shifting of the total tax burden either as among corporations or between corporation and other groups of taxpayers. Considerations of public policy may call for such shifting; however, I do not believe that this should be a consideration in deciding upon appropriate accounting in a particular area.

On this subject of taxes there have been, as you undoubtedly know, proposals for additional capital allowances for tax purposes suggested to the Congress. Some of these have been for the allow-

ance of either the replacement basis of depreciation or current cost depreciation. More recently, proposals have been made for an adjustment of depreciation, not on an annual accrual basis, but at the time property is retired and new capital expenditures are made. Briefly stated, in a year in which retirement occurs and capital expenditures are made (with some carry-over allowance) an additional allowance would be granted based upon the percentage excess of a current price index to a similar index in year of acquisition applied to historical cost of the retired assets. This idea has been described as "reinvestment depreciation."

There have been two proposals under this reinvestment depreciation plan. Each would allow a deduction in computing tax of the calculated amount of additional depreciation. In one proposal there would be an outright additional deduction, whereas in the other, the basis of new property would need to be reduced by the amount of the additional deduction. "Reinvestment depreciation" is primarily concerned with the calculation of taxes rather than financial reporting. However, it does raise certain corollary corporate accounting questions (assuming enactment). First, it does not seem at all unlikely that companies electing to claim reinvestment depreciation will be required also to give recognition to it in their accounts and financial statements. If so, would the amount thereof (less tax reduction) represent a charge to earnings or earned surplus and a credit to a segregated equity account? In the event that the additional depreciation must be applied to the tax basis of new property could we appropriately follow this treatment for corporate accounting purposes or would any reduction in basis be limited to the tax reduction? Second, if recognition in the accounts is not called for, may the tax reduction be used to increase income or must it otherwise be accounted for?

The accounting profession should be, and I believe generally is, responsive to the needs and legitimate wishes of the business community. I would like to see the avowed need in this area demonstrated by a more widespread use of the supplementary information to which I have previously referred.

Case Study in Corporate Acquisition

By J. E. Gelbert

One of the phenomenons of American business since World War II has been the number of cases involving expansion through the means of corporate merger. The use of the term merger in this instance is not within the frame of its legal or tax construction but in the broad sense of joining two or more business enterprises either through the means of a purchase or the combining of stockholders' interests. The reasons motivating these mergers are many and diverse. Corporate management, with the experience of a depression and a world conflict behind them, are acutely aware of the advantages of diversification of industry, of the maxim "to stand still is to die on the vine." On the other side of the fence are the stark facts of business existence. In days of high corporate tax rates only the big grow bigger; the smaller corporation has to have outside financial assistance in order to expand and develop. Taxes in one form or another give impetus to the trend; estate and inheritance taxes, capital gains taxes versus tax rates on dividends and salary incomes, net operating loss carry-overs, etc., ad infinitum. The motivation continues to exist—willing buyers and willing sellers.

As always, where there is a need there is someone to provide the answers. The need in this case is for an individual who has the technical know-how to get the buyers and sellers together to their mutual satisfaction. Since many of the motivating reasons behind the desire to merge are inspired by the need of tax relief, and since failure to take the proper steps can mean tax disaster, the individual most concerned with the problem of merging is the corporate tax advisor, be he head of the tax department, of counsel, or from the field of certified public accounting.

This does not mean the job of handling a merger of corporate interests is a one man job. Far from it, as the steps necessary to unite separate organizations involve many issues which are not even remotely connected with taxes. However, taxes are of the greatest importance and a successful merger of interests involves expert tax guidance not only in the mechanics of merger but in the field of estate planning, personal income taxes, compensation

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incentive programs, administrative procedures and others. All phases of the problem should be reviewed and passed upon by someone with the tax know-how.

The foregoing generalization is probably best illustrated by use of the case study method. The illustration which follows is and is not an event from real life; each of the steps involved actually happened but not in the same merger.

Early in the year 1960 the Board of Directors of the Aldex Corporation met to consider a proposal of a management committee which had been authorized to consider the advisability of expanding through the means of acquiring a going business in an entirely unrelated field of industry. Prior surveys indicated that Aldex had reached a point where further expansion in its own industry appeared unwarranted. Earnings had stabilized as had the corporation's share of its industry's market. The committee recommended diversification. The following financial information of Aldex was submitted to the Board as being of special significance:

Capital structure:

| | |
|--|---------------------|
| 4% Nonvoting Cumulative Preferred stock, | |
| \$10 par, 400,000 shares authorized, | |
| 200,000 shares outstanding | \$ 2 000 000 |
| Common stock, \$10 par, 1,000,000 shares authorized, | |
| 500,000 shares outstanding | 5 000 000 |
| Retained earnings | 18 000 000 |
| Net worth | <u>\$25 000 000</u> |

Net current assets:

| | |
|--|---------------------|
| Cash | \$ 5 000 000 |
| Accounts receivable | 6 000 000 |
| Inventories | 6 500 000 |
| Other | 500 000 |
| | <u>18 000 000</u> |
| Current liabilities | 8 000 000 |
| | <u>\$10 000 000</u> |
| Property, plant and equipment, net of depreciation | <u>\$15 000 000</u> |
| Book value per share of common | <u>\$46.00</u> |

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Earnings and dividend record:

| Year | Earnings per Share of Common | Dividends | |
|----------------|---------------------------------|-----------|--------|
| | | Preferred | Common |
| 1959 | \$6.40 | \$.40 | \$3.00 |
| 1958 | 7.20 | .40 | 4.00 |
| 1957 | 6.90 | .40 | 4.00 |
| 1956 | 4.80 | .40 | 2.00 |
| 1955 | 5.20 | .40 | 2.00 |

Market value of shares:

Common (listed on national exchange)

| | | |
|----------------|-----------|----------|
| 1958 | High \$65 | Low \$55 |
| 1959 | High 73 | Low 48 |

Current \$49

Preferred (unlisted)

All recent sales at par.

In submitting the foregoing information to the Board, the Comptroller expressed the opinion that any acquisition should provide an equal or better return on the investment in comparison to that shown by the company's own experience over the last five years. Average earnings expressed as a percentage of net worth approximated 13½%. The Comptroller also expressed the opinion that any investment should not deplete the company's cash position below an amount approximating \$3,000,000.

After reviewing the entire matter the Board adopted a resolution authorizing the management to investigate the possibilities of acquiring a business for the purpose of diversifying the operations of Aldex. The purchase price should not exceed \$5,000,000 of which only \$2,000,000 was to come from the company's cash. The balance of the purchase price could consist of preferred or common stock, debentures or funds obtained from bank loans. Particular attention should also be paid to the matter of obtaining capable management. The use of long-term contracts, deferred compensation plans, or stock options was authorized. All of the foregoing was, of course, subject to stockholder approval.

Mr. Green, a member of the Board and President of the company's chief depository bank, announced that he knew of a closely held corporation whose stockholders might be interested in selling. He believed the corporation could be purchased and that the purchase price would be within the limits set by the Board. According to Mr. Green the company had been organized just prior to

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World War II and had shown a substantial growth in the electronics field, an industry quite distinct from that carried on by Aldex. The business had originally been a partnership consisting of two individuals. One of the founders had died and his only son had inherited his stock. The son was very active in the business and, in Mr. Green's opinion, was responsible for much of the recent growth. The son and the other founder were not compatible; therefore, there was a good chance that both parties would be willing to sell their interests. Mr. Green recommended that every effort be made to retain the services of the son. The Board then authorized Mr. Green to approach the individuals involved and if they appeared interested to obtain copies of financial statements and whatever other data was available.

Several days later Mr. Green called Mr. Larry, President of Aldex, and stated that he had talked to both Mr. John Brown and Mr. George White, the stockholders of Thetaton Company, Inc., and both had expressed an interest in the matter of disposing of their stock and were willing to discuss the matter with Mr. Larry or any person designated by him to represent Aldex. Mr. Green also stated that he had obtained copies of Thetaton's audited financial statements for the last five years. These reports were received by Mr. Larry and analyzed by A. J. Deahl, the Comptroller. Subsequent preliminary negotiations resulted in an audit of Thetaton and an appraisal of its physical properties. Mr. Deahl, being satisfied with the summary of sales and cost of sales, presented the following information to Mr. Larry:

Condensed balance sheets:

| | <i>Book Values</i> | <i>Appraised Values</i> |
|--|------------------------|-----------------------------|
| Cash | \$ 500 000 | \$ 500 000 |
| Government bonds | 500 000 | 500 000 |
| Accounts receivable | 450 000 | 450 000 |
| Inventories | 350 000 | 450 000 |
| Total current assets | 1 800 000 | 1 900 000 |
| Cash surrender value of life insurance | 55 000 | 55 000 |
| Property, plant and equipment, net | 2 245 000 | 3 945 000 |
| Total assets | <u>\$4 100 000</u> | <u>\$5 900 000</u> |

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| | | |
|--|-------------|-------------|
| Accounts payable | \$ 200 000 | \$ 200 000 |
| Accrued expenses | 200 000 | 200 000 |
| Provision for taxes on income | 400 000 | 400 000 |
| | <hr/> | <hr/> |
| Total liabilities | 800 000 | 800 000 |
| Capital stock (4,500 shares authorized, 4,000 shares outstanding) | 400 000 | 400 000 |
| Retained earnings | 2 900 000 | 2 900 000 |
| Appraisal surplus | — | 1 800 000 |
| | <hr/> | <hr/> |
| | \$4 100 000 | \$5 900 000 |
| | <hr/> | <hr/> |

Summary of earnings and dividends:

| | <i>Extraordinary Deductions</i> | | |
|-------------------|---------------------------------|----------------------------|------------------|
| | <i>Earnings</i> | <i>Net of Tax Credits*</i> | <i>Dividends</i> |
| | <hr/> | <hr/> | <hr/> |
| 1959 | \$482 000 | \$60 000 | \$120 000 |
| 1958 | 456 000 | 60 000 | 100 000 |
| 1957 | 430 000 | 50 000 | 24 000 |
| 1956 | 382 000 | 40 000 | 24 000 |
| 1955 | 330 000 | 40 000 | 24 000 |
| | <hr/> | <hr/> | <hr/> |
| Average | 416 000 | 50 000 | 58 400 |

Stock ownership.

| | <i>Shares</i> |
|------------------------|---------------|
| | <hr/> |
| John Brown | 2 250 |
| George White | 1 750 |

Mr. Deahl also informed Mr. Larry he believed Aldex should attempt to acquire Thetaton at its book value (\$3,300,000) but in any case should not offer more than \$4,000,000 for the stock.

All of the foregoing information was assembled by Mr. Larry and presented to Mr. Edwards, CPA, the company's outside tax advisor, with a request for a memorandum as to the best method to be used in acquiring the operating assets of Thetaton.

Mr. Edwards' memorandum explained that there were generally two types of corporate acquisitions—tax-free and taxable. If Aldex could acquire Thetaton at its book value, assuming book values represented the tax basis of assets, there was no particular advantage to Aldex regardless of whether the transaction was tax-free or taxable, as the basis of the assets acquired would be exactly the same as in the hands of Thetaton. On the other hand,

* Principally salary paid to Mr. Brown and amounts paid into a profit-sharing plan.

if the consideration was to be in excess of the book values it would definitely be to Aldex's advantage to have a taxable transaction in order to assure a stepped-up basis for tax purposes.

The memorandum further explained the various methods by which Aldex could acquire the assets. If the transaction was to be tax-free, three methods were available:

1. A statutory merger¹ whereby Aldex would exchange its stock or securities (i.e. bonds or notes) for the stock of Thetaton whereupon Thetaton would be merged into Aldex thereby losing its identity and corporate existence. Aldex would continue as the surviving corporation in the merger. The merger would have to be in accordance with the state laws and would have to conform in all respects with the statutory requirements established by the state. The statutory merger method of acquiring a business has the advantage of permitting stock exchanges without regard to voting or preference rights of the stocks involved. The basis of the assets acquired by Aldex would be the same as the basis of the assets in the hands of Thetaton's.² No gain or loss would be recognized to the stockholders of Thetaton as long as only stock was involved in the exchange.³ If cash or securities (no securities being outstanding on Thetaton's books) were received gain would be recognized up to the amount of cash or fair market values of the securities received.⁴ In view of the amount of retained earnings shown on the books of Thetaton, the gain would in all probability be taxed as a dividend.⁵ The basis of the Aldex stock received by Thetaton's stockholders would have the same basis as their Thetaton stock.⁶

The fact that Aldex caused the assets to be received by a subsidiary corporation would have no effect upon the results.⁷ Any carry-overs of net operating losses, capital losses, unused pension credits and certain elections permitted by the Internal Revenue Code would pass to Aldex or its subsidiary including the right to use the new fast write-off depreciation methods, LIFO inventories, and other accounting procedures. The accumulated earnings or profits of Thetaton available for dividends would follow the assets.⁸

2. If Aldex preferred to bypass the formalities of a statutory method it could still obtain the stock of Thetaton in a tax-free transaction merely by exchanging its voting common stock for the stock of Thetaton.⁹ Only voting stock of Aldex could be involved in the acquisition. The use of cash, preferred stock, or securities in any degree would render the transaction taxable. The effects of this type of reorganization upon all parties involved would be exactly the same as explained under statutory mergers with the exception of

¹ Code section 368 (a) (1) (A).

² Code section 362 (b) (2).

³ Code section 354 (a) (1).

⁴ Code section 354 (a) (2) and Code section 356 (a) (1).

⁵ Code section 356 (a) (2).

⁶ Code sections 358 (a) (1) and (2).

⁷ Code section 368 (a) (2) (C).

⁸ Code section 381.

⁹ Code section 368 (a) (1) (B).

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the remarks relating to a wholly-owned subsidiary. Since Aldex would be acquiring Thetaton as a subsidiary the exception is unnecessary.

3. The third type of tax-free acquisition would consist of a deal between Aldex and Thetaton rather than with Thetaton's stockholders. In this transaction Aldex would issue its voting common stock for substantially all of the properties of Thetaton including cash and would assume Thetaton's recorded liabilities.¹⁰ Again only voting stock could be used. Substantially is a nebulous word but in this instance the exclusion of the cash surrender value of the life insurance policies would probably not affect the transaction. The transfer of the assets to a wholly-owned subsidiary is also permitted in this type of transaction. None of the parties would have any recognized gain or loss and the basis of the assets in the hands of Aldex would be the same as in the hands of Thetaton. The carry-over of losses, methods, elections, earnings and profits discussed under statutory mergers would also result in this type of transaction. Thetaton could either continue its existence or could dissolve and transfer the Aldex stock to its stockholders tax-free.

This acquisition of assets rather than stock appears on the surface to be preferable as far as Aldex is concerned as it throws the entire burden of liquidating Thetaton upon the present owners. Any unrecorded liabilities would be their responsibility and not that of Aldex. This would include any deficiencies in Federal income taxes. The memorandum emphasizes the importance of this fact in view of the possible liability of Thetaton for the surtax on improper accumulation of surplus¹¹ and the possibility that income has been understated in prior years as shown by the large difference between book inventories and their appraised values.

The memorandum continued with a discussion of the methods by which Aldex could acquire the business of Thetaton in a taxable transaction. The two avenues of approach were explained as follows:

1. A taxable acquisition of stock whereby Aldex would purchase the stock of Thetaton from its stockholders. The consideration could be entirely for cash or for part cash and part stock or securities of Aldex. In the absence of a statutory merger it would appear on the surface that the use of cash, securities or nonvoting preferred stock in any proportion would render the transaction taxable, but in order to assure a step-up in basis, the memorandum suggests that at least 21% of the consideration consist of something other than voting stock of Aldex. Thus no one could contend that Aldex had acquired control of Thetaton in exchange for its voting stock.¹²

Having acquired ownership of all the stock of Thetaton, Aldex would immediately have to proceed to liquidate Thetaton in order to assure the step-up in basis. Where stock of a subsidiary is acquired in a taxable transaction and liquidation takes place within a two-year period subsequent to the date of purchase, the basis of the assets acquired is determined by allocating the cost

¹⁰ Code section 368 (a) (1) (C).

¹¹ Code section 531.

¹² Code section 368 (c).

of the stock to the assets on the ratio of the fair market value of the assets to the total fair market value excluding cash or its equivalent from the computation.¹³ Since the assets have been appraised at values in excess of any possible purchase price, it may be presumed that all of the cost of the stock can be allocated to tangible assets and none to intangibles such as goodwill. (The Internal Revenue Service may take the position that a value should first be placed upon intangibles such as goodwill and that the purchase price should then be allocated between the tangibles and the intangibles. The author believes, however, that this position is untenable as any method of valuing intangibles should first take into consideration the rate of return upon the fair value of the tangible assets. If the fair value equals or exceeds the purchase price there can be no intangible value involved.) Immediate liquidation is recommended as otherwise two sets of books would have to be maintained to adjust for transactions taking place within the interim period.¹⁴ If Aldex failed to liquidate Thetaton within two years, the step-up in basis would be lost and only the tax basis to Thetaton would be acquired in a subsequent liquidation.¹⁵

This method of acquiring Thetaton is not recommended because Aldex would be assuming the responsibility of liquidating Thetaton and satisfying any of its unpaid liabilities.

2. The second and preferred method of accomplishing a taxable purchase would be a direct acquisition of assets from Thetaton. Again care should be exercised to be sure that substantially all of the assets are not acquired solely for voting stock. This is of course easier to accomplish in this type of transaction since it is possible to purchase only inventories and the operating plant and equipment. Cash, government securities, receivables and other miscellaneous assets would be retained by Thetaton who would also liquidate its own liabilities whether presently recorded or not. A double tax on the transaction, first on the sale by the corporation followed by a second tax at the time Thetaton was liquidated, could be avoided by having Thetaton adopt a plan of liquidation before the sale was consummated followed by complete liquidation within a one-year period.¹⁶

On or about the same time that Aldex had asked its tax advisor for suggestions as to how to acquire Thetaton, Mr. Brown and Mr. White, the stockholders of Thetaton, had individually consulted their own tax counsel as to their sides of the question.

Mr. Irvine, accountant for Mr. Brown, made the following comments. Mr. Brown was 73 years of age and a widower. Practically all of his estate was represented by his stockholdings in Thetaton. Therefore, it would appear to be a wise move from an estate planning viewpoint to exchange his stock in a closely held company for stock which could easily be disposed of on a national

¹³ Code section 334 (b).

¹⁴ Reg. 1. 334-1 (c) (4).

¹⁵ Code section 334 (a).

¹⁶ Code section 337.

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market. However, he suggested Mr. Brown insist on a nontaxable exchange. The tax basis of his Thetaton stock was very small in contrast with its present value and any taxable transaction would have the effect of diminishing the estate by approximately one-fourth. It would be much smarter for Mr. Brown to transfer his present tax base to the Aldex stock and depend upon estate tax valuation to step-up the basis for his heirs than to pay the capital gains tax during his lifetime. A fast computation produced the following comparison:

Taxable sale:

| | |
|---|-------------|
| Estimated value of Thetaton stock | \$2 500 000 |
| Tax basis | 225 000 |
| | <hr/> |
| | 2 275 000 |
| Capital gains tax | 569 000 |
| | <hr/> |
| Net estate after income tax | 1 706 000 |
| Federal and state estate taxes* | 621 000 |
| | <hr/> |
| Value of estate passing to heirs | \$1 085 000 |
| | <hr/> |

Tax-free exchange:

| | |
|---|-------------|
| Value of Aldex stock at time of death | \$2 500 000 |
| Federal and state estate taxes | 998 000 |
| | <hr/> |
| Value of estate passing to heirs | \$1 502 000 |
| | <hr/> |

Mr. White consulted with Mr. Reed, his accountant, who explained the results of the various methods of disposing of his Thetaton stock. Mr. White (who was only 46 years old) stated that in the long run the method used would not make too much difference to him as it would be his intention to dispose of most of any Aldex stock he received in order to diversify his investments. The tax basis for his Thetaton stock was \$885,000 based upon the valuation used to settle his father's estate; therefore, capital gains would not materially deplete his estate. He stated he was much more concerned with receiving a satisfactory price for his Thetaton stock and with making arrangements for an employment contract which would tend to soften the impact of income taxes and give him a chance for capital gains.

At this stage of the negotiations a conference was arranged. Mr. Larry and Mr. Deahl represented Aldex and Mr. Brown and

* State estate and inheritance taxes assumed to be equal to the state death tax credit allowed by Code section 2011.

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Mr. White represented Thetaton. Mr. Larry stated that he was authorized by his company to make an offer to buy the inventories and the property, plant and equipment of Thetaton at their book value of \$2,595,000. The consideration would consist of \$1,000,000 in cash and 31,900 shares of the common stock of Aldex at its present value of \$50 per share. Mr. White countered by stating that he had consulted with Mr. Brown and their asking price was 100,000 shares of the common stock of Aldex to be delivered in exchange for all of their shares of Thetaton. After much shadow boxing the parties found themselves at an impasse represented by the following considerations:

1. Aldex insisted Thetaton had a maximum value of \$4,000,000 and they would only purchase plant and inventories in a taxable transaction directly from Thetaton at a price of \$3,295,000.

2. Mr. Brown insisted upon a tax-free exchange but was willing to accept \$4,000,000 as the value of his Thetaton stock.

3. Mr. White agreed to the principle of a taxable transaction but insisted upon a total value of \$4,500,000 and a direct purchase of Thetaton stock.

At this point the meeting was adjourned as Mr. Larry announced he would have Mr. Edwards study the problem to see if he could find some proposal which might reconcile the various differences of the parties. Accordingly, the problem was placed in the hands of Mr. Edwards.

Several days later, after consulting all of the parties, Mr. Edwards suggested the following plan:

1. Aldex would purchase the inventories, accounts receivable and plant, property and equipment from Thetaton and would assume Thetaton's liabilities. Thetaton, Brown and White collectively would guarantee that unrecorded liabilities, including tax deficiencies, would not exceed \$50,000. The purchase price would amount to \$3,265,000 computed as follows:

| | |
|---|---------------------------|
| Assets sold: | |
| Inventories | \$ 450 000 |
| Accounts receivable | 450 000 |
| Plant, property and equipment | 3 165 000 |
| | <hr/> |
| | 4 065 000 |
| Liabilities | 800 000 |
| | <hr/> |
| Consideration | 3 265 000 |
| Assets retained: | |
| Cash | 500 000 |
| Government bonds | 500 000 |
| Life insurance | 55 000 |
| | <hr/> |
| Total value of Thetaton | <u><u>\$4 320 000</u></u> |

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The consideration in satisfaction of the purchase price would consist of \$1,020,000 in cash, 50,000 shares of preferred stock @ \$10 and 34,900 shares of common stock @ \$50.

If Aldex is called upon to pay any unrecorded liabilities up to the maximum of \$50,000 the excess would be allocated as an addition to the cost of plant, property and equipment.

2. Thetaton would not adopt a plan of liquidation. It would continue in existence and would pay income taxes on the gains arising from the sale of its inventories and plants. It is estimated these taxes would approximate \$280,000. The assets of Thetaton after payment of taxes would consist of the following:

Assets:

| | |
|--|-------------|
| Cash | \$1 240 000 |
| Government bonds | 500 000 |
| Aldex corporation: | |
| Preferred stock 50,000 shares | 500 000 |
| Common stock 34,900 shares | 1 745 000 |
| Cash surrender value of life insurance | 55 000 |
| | <hr/> |
| | \$4 040 000 |

3. Mr. White would cause his 1,750 shares of Thetaton to be redeemed by the company. As he would be severing his entire connections with Thetaton he would report the transaction as a capital gain on his income tax return.¹⁷ The gain would be computed as follows:

| | |
|--|------------|
| Cash | \$ 767 500 |
| Aldex Corporation, common stock 20,000 shares @ \$50 | 1 000 000 |
| | <hr/> |
| Redemption price | 1 767 500 |
| Tax basis | 885 000 |
| | <hr/> |
| Capital gain | \$ 882 500 |
| | <hr/> |
| Tax thereon | \$ 220 625 |
| | <hr/> |

In addition, Mr. White would sign a five-year employment contract with Aldex at an annual salary of \$40,000. He would be named Vice-President of the electronics division and be elected to the Board of Directors. The contract would contain a ten-year "noncompete" agreement. In addition, Mr. White would be granted an option to purchase 5,000 shares of Aldex stock at \$50 per share within a period of five years.

4. Mr. Brown would not redeem his shares of Thetaton which would remain in existence as a personal holding company, thereby retaining the present value of the Thetaton shares of \$2,475,000 without the necessity of paying a capital gains tax. The corporation would also keep the life insurance policies on Mr. Brown's life in force. Inasmuch as Mr. Brown would not

¹⁷ Code section 302 (b) (3).

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sever his connections with Thetaton his share of the profit sharing trust could be continued, whereas the shares of all the other participants could be satisfied by a lump-sum payment assuring them of capital gains treatment.

The foregoing plan, with each party making some concessions, was agreed upon and the transaction was closed substantially on this basis.

The Aldex-Thetaton case study is important primarily because it emphasizes what the author considers the main concern in dealing with the general topic of mergers and acquisitions. A mere knowledge of the mechanics of subchapter C of the Internal Revenue Code is not enough. The tax advisor must have knowledge and experience in many fields of taxation. The problems of the corporations must be related to the problems of the individuals involved and the transaction reviewed from every possible tax angle.

A Survey of Incentive Compensation Plans*

By Carl J. Simon

The spectre of competition haunts business in many ways. Not only must management compete for the services of labor, for a marketable product, for increased sales, and for a desirable plant location, but it also must strive to attract and hold the highest caliber of executive talent. The ability to maintain a force of capable executives is a prerequisite to successful competition.

The most obvious way to attract management talent is a high salary level. However, the progressive tax structure and the possibility of stockholder resistance often act as deterrents to uninhibited increases in salaries. Thus, the past few decades have seen the introduction and growth of alternate methods of compensation: profit-sharing plans, pension and retirement plans, restricted stock option plans, deferred compensation plans, and special treatment for executives, such as fancy private offices, executive dining rooms, chauffeur-driven cars, medical examinations and country club memberships. These alternate methods of compensation may well result in more efficient management; at the same time, they offer definite tax advantages to the executives.

One of the oldest and most successful means of attracting management talent and rewarding superior performance is the bonus or incentive compensation plan. Through such plans, executives and stockholders alike are able to achieve greater benefits and profits than would have been otherwise attained. This advantage is not necessarily inherent in an incentive compensation plan. A plan should not be designed in a vacuum but should be only a part of the total compensation program for a company.

The popularity of the idea of incentive compensation and differences in management philosophy and objectives have resulted in a great variety of plans. If a company is considering the adoption of a plan or wishes to appraise its own, it must have a basis for comparison. This article, which is drawn from a survey of 125 incentive compensation plans, is designed to provide such a basis by presenting a summary of the survey with statistics, illustrations, and, where appropriate, conclusions.

* This paper appeared in slightly modified form in *The Journal of Accountancy*, October, 1959, pp. 49-57.

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The survey was limited to current and deferred payment-type executive compensation plans based on corporate income, payable in cash or stock. It did not include stock option or profit-sharing plans (i.e., those approved by the Treasury Department), or informal bonus arrangements. The survey covered large as well as small corporations and involved approximately 100 which are listed on a national stock exchange. Many industries are numbered among the companies, including machinery and equipment, chemical and drug, aircraft, automobile, primary metal, petroleum, food processing, electrical equipment, glass, textile, tobacco, and transportation.

Objective of the Plan

Most of the plans included in the survey contain a statement of objectives. The usual purpose, expressed in general terms, is to provide incentive and reward to those who contribute to the success of the enterprise. The following is typical:

The purpose of this plan is to attract and maintain strong management and leadership for the Corporation by providing for incentive compensation, in addition to their regular compensation, for employees who are in executive, managerial or other important administrative positions and who contribute materially to the success of the business by their ability, ingenuity and industry, and to reward such employees by making them participants in the results of that success.

Definition of Income

One of the most important considerations in any incentive compensation plan is the definition of income to be used in determining the amount of the additional compensation. Many companies begin with an easily identifiable and defensible figure, such as net income reported to stockholders. One plan states this basic definition as follows:

For any year "Consolidated Net Income" shall mean the consolidated net income of the Company and its consolidated subsidiaries for such year, determined in accordance with generally accepted accounting principles, as certified by the independent public accountants of the Company and shown in the Statement of Consolidated Income published in the Company's Annual Report to its stockholders for such year.

Additions to and deductions from this income figure may be stipulated to arrive at the amount to be used in computing the incentive compensation fund. Among the items that are frequently added back to net income are income taxes and the in-

centive compensation itself. Some plans specify that capital gains should be deducted and capital losses added back; similar treatment may be given to other types of income or expenses.

"Income taxes," as defined, is usually limited to United States income and excess profits taxes; only a few plans take into account state or foreign income taxes. One of the reasons frequently given for adding back income taxes is that the executive should be held responsible for before-tax profits but not for the taxes themselves; the imposition of or the removal of an excess profits tax, for example, might act as a hardship or a windfall to the participants. Another reason sometimes advanced for using before-tax income is that the percentage used is only about one-half of that required to attain the same distribution if the compensation were based on after-tax income.

The arguments on the other side state that income taxes are an expense to the business like any other expense and that management should be charged with the responsibility for keeping the tax expense at a minimum; in addition, stockholders, who share in the profits, must bear the consequences of changes in tax rates and management should be in a similar position.

The survey indicates that 73 plans define income as meaning before taxes, and 52 plans define it as meaning after taxes. A few of the latter plans, established in the late '40's, deduct a fixed rate of 38 per cent of income before taxes.

Of the plans surveyed, 75 provide that the bonus itself should be added back in determining income for purposes of executive compensation. This provision is defensible on the ground that the participants should not be charged with the bonus expense itself as well as on the practical grounds that it eliminates the necessity of using algebraic equations in the formula.

Much attention has been paid in recent years to the question of excluding capital gains and losses from the income figure used in computing the bonus. Despite such attention, and despite the amendment of plans by a few companies to exclude capital gains and losses, the survey indicates no general trend in this direction, since only 17 of the 125 plans have such a provision. The writer feels that incentive compensation plans should not exclude capital gains and losses for the following reasons:

1. It is difficult to provide a definition of capital gains and losses which may be applied in all cases.

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2. The bonus paid to participants should represent a reward for conducting all the affairs of the company, including the decision to sell assets which result in capital gains and losses.

3. A profit or loss resulting from the disposition of an asset often arises because of inaccurate depreciation allowances in the past, and a substantial part of the apparent profit or loss is merely an adjustment of prior years' depreciation expense which has been charged against the bonus base.

4. A profit may also reflect management's business acumen in making the investment in the first place or in finding a buyer willing to pay the price asked by the company.

If it is decided to exclude capital gains and losses from the base for computing the bonus, the company should make every effort to spell out in detail exactly what types of transactions are meant. Otherwise, there may well be areas of doubt arising in each year as to the correct amount of income subject to the bonus computation.

Eighteen plans provide that special or nonrecurring items of gain or loss may be excluded from the computation of income at the discretion of the bonus committee or the board of directors. One company uses the following wording:

... excluding such unusual items of income or loss as, in the discretion of the Board of Directors, should not be included in the current year's earnings for such purpose.

In the writer's opinion, such a provision offers a good solution to the problem of including or excluding unusual items so long as the persons exercising the discretionary powers are independent of those who receive the additional compensation. This provision might be applied if, for example, adjustments affecting income of years before the present management took office or before adoption of the plan (such as sale of an idle plant, federal income tax adjustments, and the like) were reflected in the current year's income account. Under these circumstances, current management probably should not receive a windfall or be penalized; such items might be eliminated after due deliberation.

A number of the 125 plans included in the survey exclude from the definition of income such items as interest on long-term indebtedness (17), income from certain subsidiaries and affiliates (15), contributions to pension and other employee benefit plans (10), or proceeds from life insurance policies (2). Interest on indebtedness is usually added back only if the plan provides that no bonus is payable until the return on capital, including by definition long-term debt, exceeds a specified amount or percentage.

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Adding back the interest expense in this case prevents a "double charge" in the plan.

The following tables summarize the results of the survey with regard to the definition of income for purposes of the bonus computation:

STARTING POINT FOR DETERMINING INCOME

| | <i>Number</i> |
|---|---------------|
| After taxes and after incentive compensation..... | 22 |
| Before taxes (after incentive compensation)..... | 28 |
| Before incentive compensation (after taxes)..... | 30 |
| Before taxes and before incentive compensation..... | 45 |
| Total..... | 125 |

EXCLUSIONS

| | |
|--|------|
| No exclusions..... | 55 |
| Capital gains and/or losses..... | 17 |
| Interest on long-term indebtedness..... | 17 |
| Income from certain subsidiaries and affiliates..... | 15 |
| Contributions to pension and other employee benefit plans..... | 10 |
| Other exclusions..... | 23 |
| At the discretion of the board of directors or administering committee | 18 |
| To eliminate duplications (plans excluding more than one type of item) | (30) |
| Total..... | 125 |

Deductions from Income

In most plans included in the survey, the executives do not begin to earn a bonus until some part of the income has been reserved for stockholders or for reinvestment. Fifty-six plans require that a specified percentage of capital employed be deducted from income before any bonus is earned; 17 plans deduct a specified dollar amount from income; 16 plans deduct a stated amount per share of common stock or the requirements for dividends on preferred stock; and 12 plans require a combination of the deductions or permit alternate deductions. Typical provisions covering these deductions are as follows:

The Company shall establish and maintain a Supplemental Compensation Reserve to which shall be credited for each year an amount equal to 6% of the Income for such year, after first deducting from the amount of such Income an amount equal to 10% of the Capital Employed in the Business.

A bonus reserve shall be maintained by the Company to which shall be credited for each calendar year an amount equal to 6% of net earnings of the Company in excess of \$500,000.

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Out of the consolidated net income . . . , the Board may set aside, on the recommendation of the Committee, not more than 10% of the amount by which consolidated net income exceeds \$1.50 for each share of the Capital Stock of the Corporation outstanding at the close of such year.

All of the 60 plans (56 mentioned above and four with alternate deductions) which require the deduction of a return on capital employed include capital stock, capital surplus and earned surplus in the definition of capital. Twenty-four plans require the addition to capital of long-term debt on the premise that stockholders are entitled to the first return from the investment of such funds, and of these 24 plans, 17 preclude the double charge mentioned earlier by adding back interest on long-term debt to income for bonus computation purposes. Other adjustments to the basic definition of employed capital, which occur infrequently, provide for deducting such items as treasury stock, appraisal surplus, or investment in partly owned subsidiaries.

In defining capital employed, the date at which it is computed has significance. Three plans state that the capital should be computed at the end of the year; since the bonus is a factor in determining capital at that time and since the capital at that time is a factor in determining the bonus, it is necessary to revert to an algebraic equation. Another disadvantage of using capital at the end of the year is that the issuance of new stock or bonds in December, for example, would work a hardship on the participants who would be expected to have realized a return on this additional capital for an eleven-month period prior to receipt of the proceeds. Fifteen plans provide that capital employed shall be determined at the beginning of the year (which also has a disadvantage in that the management is not required to earn any return on stock or bonds issued during the year, even if the transaction occurred in January). Fifteen more plans begin with capital at the beginning of the year with adjustments for issuance of new stock or debt and retirement of stock or debt. The writer believes this to be the most equitable method of determining capital employed for purposes of bonus computations. Sixteen plans in the survey use a monthly average of capital employed or an average of the beginning and end of the year figures; the remaining 11 of the 60 plans do not state specifically the date at which capital employed should be computed.

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An excellent definition of capital employed, used with slight variations in a number of plans, is as follows:

The term shall mean the total of capital stock, paid-in surplus and retained earnings plus debt [defined elsewhere as long-term debt] as shown in the statement of financial position as of the end of the year preceding the year for which Incentive Earnings are to be computed, less any treasury stock at cost, plus or minus a proportionate allowance for any change during the year, based on the period of such change, in the amount of capital stock, paid-in surplus, or debt, from newly issued or finally retired capital stock, except treasury stock previously deducted, or from increase or decrease in the outstanding principal of debt.

Conditions and Limitations

As an alternative to the deductions from income discussed above, and sometimes in addition thereto, some plans state that no bonus shall be paid unless certain conditions are met. Other plans place limitations on the maximum amount of the bonus. For example, one plan states:

No credit shall be made to the reserve for and in respect of any year in which dividends aggregating \$2 per share have not been declared and paid on the Common Stock of the Company.

Another plan limits the maximum amount of the bonus in the following manner:

The amount of such provision made for any year shall in no event exceed the amount or value of dividends paid thereon during such year.

Still another plan bases its limitation on the salaries of the participants. It states:

In any one year the total paid to the group from the fund so provided may not exceed 50% of the total base salaries of the participants nor may payments to any participant exceed 50% of his base salary.

Of the 16 plans that base limitations on salaries of participants, 6 place the maximum at 100% of base salaries, 4 place it at 50%, 1 at 25%, 1 at 20%, 2 at 15%, 1 at 10%, and the remaining plan does not indicate the percentage used. Without knowing the salary and total compensation policies of the companies, one should not place undue emphasis on the percentage limitations. However, there is little doubt that such a provision tends to make incentive compensation plans more palatable when stockholder approval is requested.

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The following table summarizes the limitations included in the various plans:

| | <i>Number</i> |
|--|---------------|
| Dividends in stated amount per share must have been paid..... | 17 |
| Bonus must not reduce income below: | |
| A fixed dollar amount..... | 2 |
| A stated amount per share..... | 8 |
| A stated return on capital..... | 10 |
| Bonus must not exceed a stated percentage of dividends paid..... | 9 |
| Bonus must not exceed a stated percentage of participants' salaries... | 16 |
| Other..... | 3 |
| To eliminate duplications (plans with more than one type of limitation) (12) | |
| Plans with no limitations..... | 72 |
| Total..... | 125 |

Computation of the Bonus Amount

The majority of the plans included in the survey use a percentage of income to compute the bonus amount. The various methods employed are set forth below:

| | <i>Number</i> |
|---|---------------|
| Flat percentage of income..... | 87 |
| Flat percentage of income with limitations..... | 4 |
| Ascending percentage of income..... | 12 |
| Descending percentage of income..... | 9 |
| Other..... | 13 |
| Total..... | 125 |

It is apparent that most of these companies favor the use of a flat percentage of income. The actual rates used are, to a great extent, meaningless because of the effect of deductions, restrictions and limitations before applying the percentage. Also, it should not be forgotten that incentive compensation is only one segment of the total compensation structure and should not be appraised without considering salaries and other benefits.

It might be of interest, however, to note that, while the rates range from 1 to 25 per cent, the rate most frequently used is 10 per cent, and two-thirds of all plans use between 5 and 12½ per cent. Rates are generally higher when based on after-tax income, but they do not vary proportionately to the federal income tax rate. The arithmetic average for before-tax plans is 8.4 per cent, and 10 per cent for after-tax plans. A general conclusion

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from this fact might be, without considering other important factors, that plans basing bonus on income before taxes are more liberal than those using income after taxes.

A few companies use a rather unusual method for determining the actual amount of the bonus. The plan may provide, for example, that if net income is between \$1,000,000 and \$1,200,000, each participant will receive 10 per cent of his base salary; if net income is between \$1,200,000 and \$1,400,000, each participant will receive 12 per cent of his base salary, etc. In the writer's opinion, this method of determining the bonus amount has a serious disadvantage. Since the bonus amount is a percentage of the total base salaries of the participants, management may increase the gross amount of the bonus by either adding more participants or by granting raises to the participants. It would seem that a plan is more effective if increases in the total bonus result only from increases in net income.

Carry-Over of Fund

A number of plans provide that the entire amount of the bonus must be distributed each year; others provide that the board of directors or administering committee has the right to pay less than the total available, with any amounts not paid out reverting to the general funds. Still other plans provide that the unexpended portion of the bonus should be placed in a liability account and may be distributed in future years. Approximately one-half of the plans surveyed incorporate the carry-over feature.

Eligibility

Selecting the participants in an executive compensation plan presents a difficult problem. Spreading the fund over too many participants may reduce the size of an individual's bonus below that generally regarded as sufficient to provide a real incentive. Concentrating the bonus in the hands of relatively few individuals may result in excluding members of the management team who should participate. It is therefore only logical that a majority of the plans surveyed provide that determination of the participants shall rest exclusively within the discretion of the president, the board of directors or the compensation committee. One plan expresses the eligibility requirements as follows:

The individuals eligible to receive awards under the Plan shall be such Employees as the Committee shall determine each year are key employees

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who are in positions to contribute to a substantial degree to the success of the Company.

Other plans actually designate the management positions that will participate and may even state the percentage of participation of each. An example of this type follows:

The following executives shall participate in moneys payable under the plan in the following percentages:

| | |
|---------------------|-------|
| President..... | 30.0% |
| Vice President..... | 22.5 |
| Treasurer..... | 22.5 |
| Sales Manager..... | 10.0 |
| Secretary..... | 5.0 |
| | <hr/> |
| | 90.0% |
| | <hr/> |

The remaining 10 per cent shall be distributed to such persons and in such amounts as the Board of Directors shall direct.

The following table indicates the various methods used for determining eligibility requirements. In a number of cases where a minimum salary is the prerequisite, the committee or board of directors may, in special circumstances, exclude individuals making more than the minimum and include some making less than the minimum.

| | Number |
|---|--------|
| Determined by president, board of directors or committee..... | 92 |
| Designated officers or positions..... | 14 |
| Minimum salary level..... | 15 |
| Minimum period of service..... | 1 |
| No information..... | 3 |
| | <hr/> |
| Total..... | 125 |
| | <hr/> |

Allocation to Participants

To a participant in any plan, the most important consideration is the method of allocating the bonus among the participants. Most plans provide that the allocation should be left to the discretion of the administering body, whether it be the board of directors, a committee, or top management. The belief is that only by making the awards completely discretionary can outstanding merit be properly rewarded and that it is foolish to assert that everyone makes the same or even a proportionate contribution to the success of the company. It is also felt that

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this discretionary power is a valuable one and should be exercised by management. On the other hand, a sizable minority of the plans provide that the bonus shall be divided among the participants in proportion to the base salaries of the participants. The justification for this method is that management works as a team and that the success obtained would have been impossible without the contribution of all members of management. It is also felt that many discretionary awards are actually made (after due deliberation by the administrative body) on the basis of relative salaries and that awards not so made may reflect nothing more than personal favoritism or antipathy toward individuals.

Provisions setting forth two different methods of allocating the bonus are shown below:

Subject to the foregoing limitations . . . , the total amount of additional compensation, if any, that may be authorized for any year, the participants in such additional compensation, the apportionment thereof among such participants and the time or times of payment thereof shall be determined by a Committee of the Board of Directors.

As soon as convenient after the end of each calendar year there shall be paid to the employees described above, in proportion to their respective salaries during such calendar year . . . 5% of the gross profits of the Company for the preceding calendar year in excess of gross profits in the sum of \$4,500,000 for such calendar year.

The table below illustrates the different methods of allocating the bonus among the participants:

| | <i>Number</i> |
|--|---------------|
| At discretion of administrative body | 90 |
| In relation to salaries of participants | 29 |
| In relation to shares assigned to participants | 10 |
| Other | 2 |
| No information | 2 |
| To eliminate duplications | (8) |
| Total | 125 |

Payment—Cash or Stock

The earliest incentive compensation plans made payments to participants generally in cash and generally at the end of the company's fiscal year. In recent years, however, a number of plans have incorporated stock payment provisions, whereby some or all of the bonus is payable in common stock of the company. The theory behind stock payment is as follows: first, the employee participates in the growth of the company not only during the

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current year but during future years as well; second, management-ownership is encouraged; and third, if previously unissued stock is used, cash is conserved. Twenty-six plans permit the payment of some or all of the bonus in stock, and ninety-nine either specify cash payments or are silent. One of the plans that permits payment in cash or in stock states as follows:

In the discretion of the Committee, incentive compensation awards for any year may be in common stock of the Company, or in cash, or partly in such common stock and partly in cash.

When a plan permits payment in either cash or common stock, it usually states that the choice is at the discretion of the committee, as in the example above. Frequently, the intent is that participants receiving smaller bonuses will receive cash while those entitled to larger bonuses will be paid in stock. One plan makes this intent clear by using the following paragraph:

With respect to any key employee eligible for incentive compensation whose incentive compensation is \$10,000 or more and whose total compensation is the sum of \$50,000 or more, the Board of Directors may, in its sole discretion it elects so to do, authorize by individual contract between the Company and each such individual employee, selected by the Board of Directors from within the said class, the following individual plan.

The individual plan mentioned refers to payment partly in cash and partly in a contingent allotment of stock payable after retirement.

Time of Payment—Cash

There are three general methods for paying a cash bonus: immediately (which may include estimated amounts during the year the bonus is earned, with the remainder paid as soon as the exact amount is known); in instalments (usually limited to a maximum of five years); or deferred until retirement, death or separation. Combinations of two or even all of the above methods are quite common, and each method has its advantages.

Immediate payment of the bonus represents, in theory at least, the proper manner of rewarding participants under a true incentive plan. If the company has a good year, the employees who share in the plan receive an immediate reward; if the company has an unsuccessful year, the participants get a small bonus or possibly no bonus at all. Since the reward for successful performance is paid at once, a psychological goad is always present. In addition, if the bonus earned is relatively small, dividing it

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into still smaller segments for purposes of paying in instalments or deferring it may reduce the amount currently paid below the minimum amount needed to offer an incentive. Because of this factor, bonuses to middle management employees are frequently paid immediately even if bonuses to top executives are deferred. The wording in one plan reads as follows:

Awards from the Fund with respect to any year shall be paid in cash and payment thereof shall be made as soon as practicable after the independent auditors of the Corporation shall have completed the annual audit of the Corporation's accounts for such year.

Payment in instalments also offers certain advantages. If the profits of the business are volatile and fluctuate widely from year to year, the participants are enabled better to plan their personal finances since fluctuations in their income are to some extent leveled. This leveling process will also save money for participants on the cash basis for tax purposes, because of the progressive rate tax structure. From the company's standpoint, an important advantage is the hold that it can exercise over the participants in the plan. Since the participants under most plans of this type must "earn out" the instalments by remaining in the employ of the company, they are less likely, for example, to accept lucrative offers from competitors at the expense of losing their equity in a substantial bonus. On the other hand, the company retains the right to discharge the employee and, depending on the reason for the discharge and the terms of the incentive compensation plan, may or may not pay the instalments not yet "earned out."

Payment of bonuses in instalments is used by many of the leading companies in the country. One plan provides for instalments as follows:

Upon final determination of bonus awards by the Committee, each award of \$1,000 or less shall be paid at the time of award. Each award of more than \$1,000 shall be paid in annual instalments of 20% or \$1,000, whichever is greater, the first such instalment at the time of award and the remaining instalments in January of each succeeding year if earned out by the beneficiary by continuing service with the Corporation at the rate of 1/12th of the amount of the first instalment for each complete month of service beginning with January of the year of determination.

None of the plans in the survey require deferred payment of cash bonuses, although some permit the time of payment to be determined by the administering committee. For example, one plan states as follows:

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In its discretion the Incentive Committee may direct that the amount allocated to any participant for any fiscal year shall be deferred and paid to him, his designated beneficiary or his estate in specified instalments following his retirement, death or termination of service.

This plan goes on to set up conditions designed to prevent the deferred amount from being taxable to the participant in the year the bonus is declared. The language used is as follows:

When payments to participants are deferred pursuant to this paragraph, the Incentive Committee in its discretion may direct that such payments be conditioned upon the participant's continued employment, his keeping himself available after retirement as a consultant, his abstaining from any practice which tends to compete with or harm the corporation, or any similar conditions specified by the Incentive Committee.

Under Rev. Rul. 60-31, I.R.B. 1960-5, 17, it would appear no longer necessary to include such conditions in a deferred plan. The ruling holds that so long as the future payment of the deferred compensation is merely a contractual obligation of the employer and is not funded or secured by any arrangement with a trustee or escrow agent and no other circumstances suggesting constructive receipt are present, a cash basis employee will not be taxable until the compensation is actually paid. There is of course no objective to including the conditions in the plan if the employer desires such protection.

Some participants prefer to receive their bonus immediately while others favor deferment of all or a part of the incentive compensation. Those preferring the deferred feature realize that they are able to build up a retirement fund for themselves and an estate for their families and that the income, which is taxable when received, will presumably be taxed at a lower rate. Other participants may feel that since they have earned the money, they should be entitled to its immediate use and should be permitted to establish their own retirement program. In addition, some people fear that inflation may cause an erosion in the economic value of the accumulated funds. This last factor is one of the reasons for the adoption of plans calling for payment of the deferred bonus in common stock, rather than cash.

Time of Payment—Stock

Of the 26 plans permitting payment of the bonus in either cash or common stock, four provide that the stock must be distributed immediately. One plan states that the stock bonus is to be paid in instalments not exceeding five years, and eight provide

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that any payment in stock must be deferred until retirement, death or separation. The remaining 13 plans have combination features, ten permitting either current payment or payment in instalments, and three plans permitting current or deferred payments.

All of the plans specifically state that the stock to be distributed should be common stock of the company. Whether the stock is to be treasury or newly issued stock appears to be a matter of choice: twelve plans specify treasury stock, one plan requires newly issued stock, seven plans permit either, and six make no mention of the type to be used.

When common stock is involved, the company must set a value per share in order to determine how many shares of stock are to be awarded to each participant. Of the 12 plans specifying that only treasury stock may be used, six provide that the average value of all stock acquired for the bonus plan is the basis. One of these plans states:

The value per share at which acquired stock will be awarded in any year . . . shall be an amount equal to the average value at which all shares in the bonus account are carried on the books of the Company on such date as may be fixed by the . . . Company.

Two plans requiring treasury stock fix the value at the closing price at which the stock was sold on a national exchange on the day before the award; one uses the mean price on the date of award; one fixes the value at 80 per cent of the average of the daily bid and asked prices for the 30 days prior to the award; one averages the high and low sales price on the last day of each month during the year of award; and the remaining plan states as follows:

Treasury stock used for Incentive Awards shall be valued for award purposes at the average of the daily closing market prices at which . . . stock sold . . . for the first twenty-five trading days out of the thirty trading days immediately preceding the date of the Committee's determination of individual Incentive Awards.

The one plan that requires newly issued stock defines the value to be used as follows:

The value of the common stock delivered to a member pursuant to this Plan shall be the last sale price of . . . common stock . . . on the day the Company's Auditor certifies the Company's annual audit.

Of the remaining plans, the most popular method of valuing the stock appears to be the closing price on the day prior to the award.

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When the stock is distributed currently, no problem exists as to the treatment of cash dividends. If the distribution is deferred or in instalments, the plan should specify what happens to the cash dividends that the participant would have received if he had owned the stock during the waiting period. The following table summarizes this information for the 22 plans that do not require current distribution:

| | <i>Number</i> |
|---|---------------|
| Dividends not paid or credited..... | 1 |
| Dividends paid to participants on regular dividend dates..... | 3 |
| Dividends accumulated and paid in cash at time stock is distributed.. | 11 |
| Dividends converted to stock, thus increasing number of shares deferred | 2 |
| No information..... | 5 |
| Total..... | 22 |

The use of the word "dividends" in the paragraph above may be somewhat of a misnomer, since dividends are not actually paid on treasury or unissued stock. To avoid possible misinterpretation, a number of plans use terms such as "dividend equivalents" or "dividend units." One of the plans handles this matter as follows:

There shall also be credited contingently to the Participant's account an amount equivalent to the cash dividends and the cash value of any property dividends (herein referred to as "dividend equivalents") that would have been paid upon the "Share Units" credited to the Participant's account on the record dates of such dividends, if said "Share Units" had then been stock of the Corporation issued and outstanding.

Many of the plans that defer the payment of stock provide that the stock will not actually be issued or purchased until time of payment. Until that time, the stock is represented only by a record maintained by the company. This record indicates the number of shares owed to the participant and accumulates the dividend equivalents to be paid. The fact that the stock does not actually exist has led to the use of the term "shadow stock" to describe this type of plan. Other companies may refer to "basic units," "contingent allotments," "share units" or a similar term.

Stock payments after retirement are usually paid over a ten-year period. Of the 11 plans that permit deferment, two state that payment shall be made over ten years, two state "not more than ten years," one spreads payments over 15 years but not past age 80, one is silent, and the other five use language similar to the following:

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The number of such instalments shall be ten if employment terminates at age 65 or over, eleven if employment terminates at age 64, twelve if employment terminates at age 63, thirteen if employment terminates at age 62, fourteen if employment terminates at age 61, and fifteen if employment terminates prior to age 61.

Other Provisions

Many of the plans included in the survey have paragraphs covering other matters, such as indemnification of the incentive compensation committee, amendments to the plan, expenses of the plan, and changes in the company's fiscal year. With regard to the last two subjects, one plan states:

In the event of any change in the Corporation's fiscal year, the Plan shall apply to any intermediate period not consisting of twelve months and shall then apply to each succeeding fiscal year.

The expenses of administering the Plan shall not be charged against the Account.

A few plans, on the other hand, do provide that the expenses of administering the plan should be charged to the bonus fund.

With regard to amending or terminating the plan, the board of directors is usually given the authority to make changes, with some limitations. For example:

The Board of Directors may from time to time amend, modify, change suspend or terminate, in whole or in part and if terminated, may reinstate any or all of the provisions of the Plan, except that:

(1) No amendment, modification, change, suspension or termination may, without his consent, affect the payment to any participant of any participation awarded to him prior to the effective date of such amendment, modification, change, suspension or termination;

(2) No amendment, modification or change may withdraw the obligation and right of interpretation and administration of the Plan from a Committee of the Board of Directors, no member of which (except the ex officio member) is eligible to participate under the Plan, without the prior approval of the stockholders of the Corporation; and

(3) No amendment, modification or change may be made which will increase the amount which may be appropriated to the Incentive Compensation Account as hereinabove provided without the prior approval of the stockholders of the Corporation.

Occasionally, the board may be empowered to amend or terminate the plan without any limitations; this power is usually granted only if the plan was not submitted for approval to stockholders.

An example of the provision that indemnifies the members of the administering committee is as follows:

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No member of the Committee shall be liable for any act, omission, determination, construction or communication made by himself, the Committee or by any other member thereof, except to the extent that the same shall constitute wilful misconduct upon his part, and the Corporation hereby agrees to indemnify and save harmless each person acting as a member of the Committee from all loss or damage that may or might result from his acts as such member, except such acts as constitute wilful misconduct upon his part.

Recent Developments

Many companies have continued to examine the possibility of changing their plans with a view to providing additional benefits to executives in high tax brackets. One development which has been publicized recently is the integration of the deferred stock bonus with a restricted stock option plan. The purpose of this integration is to permit the participant to take advantage of increases in market value of the stock at the lowest possible tax cost.

A development in deferred cash compensation plans is that the amount to be paid upon retirement not be fixed but be pegged to some sort of index. Suggested indices have included assets, sales, or profits of the company, salaries for comparable positions, or national indices, such as those supplied by the Bureau of Labor Statistics. The purpose of this feature is to provide protection for the participant against inflationary trends; the feature would benefit the company in the event of a depression unless downward adjustments were not permitted under the provisions of the plan.

The two examples above are presented just to show that executive compensation plans are not finite but continue to evolve and are subject to change. It is true that a plan which has been successful in the past must have been a good plan, but it does not necessarily follow that developments in executive compensation since the plan was adopted could not be incorporated to result in an even better plan. A critical review of plans which have been in existence for a number of years may pay dividends if goals and incentives are redefined, if salaries and other compensation are brought into line with current thinking, and if the plan is modernized to take advantage of recent developments.

Summary

In this article, the writer has not attempted to define an incentive compensation plan that would be ideal for all companies; no such plan exists. Instead, the article is intended to point out current practices as found in the survey undertaken for this pur-

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pose. It offers information as to alternative provisions which may be adopted and indicates areas of unanimity or near-unanimity which possibly should appear in most plans. Basically, however, each plan should be tailored to the requirements of the individual company; each plan should be considered as part of the total compensation structure; and each plan that is adopted should be reviewed regularly to take advantage of current developments in the fields of incentive compensation and related taxes. Only in this way can a plan hope to do what is expected of it—to provide an incentive to the employees which will result in greater benefits to them, the company, and its stockholders.



The presentation by Mr. Richard W. Russell (left) of a scholarship awarded by the Los Angeles partners to Mr. Larry A. Lechner at a meeting of the Iota Chapter of Beta Alpha Psi, University of Southern California.

The Role of the Accountant in the Administration of an Estate

By G. W. Welsch

Many articles have been written recently describing the role of the accountant in business and tax matters and the relationship between the legal and accounting professions. One of the most interesting articles on this subject is *Accountant as Problem-Discoverer*, a transcript of an address delivered at the Tenth Tax Institute of the University of Southern California School of Law, Los Angeles, in the spring of 1958, by Louis M. Brown, a member of the California Bar Association and the Section of Taxation of the American Bar Association. In this paper, Mr. Brown describes the accountant as "a problem-discoverer," "a historian," a recorder of yesterday's facts, and a forecaster of the future. All of these functions are essential to the successful administration of an estate.

Of course the ideal situation exists where the accountant long has been associated with the decedent, having periodically reviewed his financial records and prepared his tax returns. The familiarity with a client's affairs, which an accountant gains by the very nature of his work and through long and close association with a client, can simplify immeasurably the tasks of the executor and the attorney in the administration of the estate. However, even where the decedent did not employ an accountant during his lifetime, the services and skills of an accountant are still needed for the proper administration of the estate. The accountant who is not familiar with the decedent's affairs has, of course, a more difficult job than one who has been employed during the lifetime of the decedent; but by his skills and training, he is qualified to perform the accounting functions required and to assist in the efficient administration of the estate.

Let us discuss some of the areas which require the services of an accountant. Probably the first order of business in the administration of the estate is to determine the nature, location, and value of the assets which comprise the estate and the existence, nature, and amount of any liabilities of the decedent. In other words, a financial statement must be prepared for the decedent. The accountant is best qualified to prepare this statement. A

mere listing of the assets is not enough. The value of each of the assets must be determined. Where stock of a closely held corporation is an asset of the estate, it is the accountant, who, by his training, is qualified to review the financial statements of such a corporation, to analyze its record of earnings and dividends for prior years, and to arrive at a proper valuation of the stock.

In a community property state, such as Texas, it frequently is necessary to distinguish between separate and community property. While it is the attorney who must determine the nature of the property under the community property laws, it usually is the accountant who analyzes the various financial transactions to get the facts upon which the attorney can base his judgment. These include source of funds, date of purchase, nature of assets, date of marriage, period of residence in the state, etc.

A bare tabulation of the assets and liabilities of the decedent does not provide sufficient information for the preparation of an estate tax return. Numerous questions must be answered in the return. Questions such as those regarding transfers during the decedent's life (Schedule G) can prove troublesome. Unless the decedent maintained adequate records during his lifetime, considerable analysis of transactions may be necessary to enable the preparer to answer them. This is another area in the administration of an estate which requires close cooperation between the accountant and the attorney for the estate. The accountant in his role as a tracer and recorder of transactions can determine the facts with respect to any transfers made by a decedent during his lifetime, but it is necessary that the attorney make decisions with respect to the legal effects of such transfers and to the manner in which they should be reported. In addition to the general requirement for the reporting of all transfers of \$5,000 or more made by the decedent during his lifetime, without adequate and full consideration in money or money's worth, the instructions for Schedule G describe six different types of transfers that require inclusion of the value of the property transferred in the gross estate of the decedent.

Whether or not a particular transaction is taxable often presents a close legal question. For example, if a decedent transferred property during his lifetime, retaining the income for life, and he did not receive adequate consideration for the value of the remainder interest so transferred, the property is includible in his estate. On the other hand, assume that a Texas couple had an

estate consisting solely of community property. In his will the husband disposed of the entire community, leaving the income to the wife for life, with remainder to the children, thus putting the wife to the election of either taking her half of the community outright or accepting the will as a whole. Some 25 years later the wife died. Obviously, she has transferred property during her lifetime, i.e., her half of the community estate, retaining a life interest therein. As consideration for this transfer, however, she received a life interest in her husband's half of the community property. Is this the type of consideration which will satisfy the statutory requirements, so that no part of this property will be includible in the wife's estate? This question is presently pending before the Tax Court in a docketed case, and there are at least three Court of Appeals cases bearing on the point. If the receipt of a life estate in the husband's half of the community estate constitutes consideration for the transfer of the wife's remainder interest in the other half, how is this consideration measured? If the wife outlived her life expectancy, as indicated by the Government's tables at the time of her husband's death, do you use her actual life span or her anticipated life span in figuring the value of her life estate? Moreover, do you use the $3\frac{1}{2}\%$ yield on which the tables are based or the actual income? These questions are still unresolved.

If the estate intends to litigate points, it is the attorney who must choose the forum. In other words, should the estate initially concur in the Treasury's position, pay the tax, file claims for refund, and sue in a District Court or the Court of Claims or should the return be filed in a manner most favorable to the estate, so that the matter can be litigated in the Tax Court? One of the factors which will influence the judgment of the attorney will be the size of the deficiency and the amount of interest that will be at stake in the event of a final adverse decision. The accountant can supply the attorney with all of the figures he will need.

After determining the location, value, and nature of all liabilities and assets of the estate, the accountant should open a set of books for the estate, so that all transactions of the estate can be recorded. The accountant should also make sure the books are maintained currently; this will save an expensive, time consuming "write-up" later.

Thus, the accountant, as a tracer and recorder of transactions, can perform invaluable service during the period of the adminis-

tration of an estate. The accountant can perform an equally valuable service as a forecaster of the future. There are many elections available to an executor or administrator under the complex provisions of the Internal Revenue Code. The selection of the proper elections to minimize total taxes for the estate and the beneficiaries requires a forecast of the nature, timing, and amount of income to be received by each during the several years that the estate will be in administration.

When a taxpayer dies, his estate comes into being; and it is a separate taxable entity for income tax purposes. It may choose any fiscal year ending not more than 12 months after the end of the month prior to the date of death. Thus, if the taxpayer died in December, 1959, the estate's first fiscal year would have to end not later than November 30, 1960; it could end as early as December 31, 1959. The estate is generally taxed on all income received (or accrued) during its fiscal year which is not distributed to beneficiaries of the estate. The beneficiaries of an estate are generally taxed on distributions to them from the income of the estate. Such distributions are reportable by a beneficiary in his return for his taxable year with which or in which the taxable year of the estate ends. The five-year throwback rule is applicable to certain distributions from trusts but does not apply to estates. Thus, income retained by an estate—and therefore taxed to it—may be distributed tax-free to the beneficiaries in a subsequent year when the estate has no taxable income or has distributed all of such year's taxable income.

The selection of a proper fiscal year and the determination of the proper timing and amount of distributions by the estate can substantially reduce the over-all tax burden. The computations and forecasts prepared by the accountant for the estate enable the executor to select the most advantageous combinations.

Forecasting of income is advantageous in determining the proper treatment of administration expenses, losses during administration, and medical expenses of the decedent during his last illness. There are optional methods of treating these items and computations must be made to determine which treatment will provide the best tax results. Administration expenses and losses during the administration of an estate may be taken either as deductions in computing the taxable income of the estate or as a reduction in the value of the estate for estate tax purposes. It is not necessary that the total deductions, or even the total

amount of any deduction, be treated in the same way. One deduction or a portion of a deduction may be claimed for income tax purposes, while another deduction or portion thereof is claimed for estate tax purposes. In order to claim the deduction for income tax purposes, a statement must be filed in duplicate to the effect that the items have not been allowed as a deduction from the gross estate of the decedent and that all rights to have such items allowed at any time as deductions for estate tax purposes are waived. Allowance of a deduction in computing an estate's taxable income is not precluded by claiming a deduction in the estate tax return, so long as the estate tax deduction is not finally allowed, and the statement is filed. After a statement is filed claiming the deduction for income tax purposes, however, that item cannot thereafter be allowed as a deduction for estate tax purposes; the waiver operates as a relinquishment of the right to have the deduction so allowed at any time. Thus, the usual procedure is to claim all items in the estate tax return. If subsequent computations indicate that deducting part or all of the items for income tax purposes would produce a better result, the statement electing such treatment should be filed.

If computations indicate that administration expenses and losses should be used to reduce the value of the taxable estate, timing of transactions is not of major importance in tax planning. If a better result can be obtained by deducting such items for income tax purposes, however, losses should be accelerated or postponed to, and administration expenses should be paid at, such times as will provide the maximum benefit. Proper timing of transactions requires adequate knowledge of current and past transactions and accurate forecasts of future income and deductions, providing this information is part of the accountant's function.

Medical expenses of the decedent, which are paid by his estate during the one-year period following the day of his death, may be considered as paid by the decedent at the time the services were rendered and used to reduce decedent's taxable income. Alternatively, they may be considered to be a debt of decedent, thus reducing his taxable estate. If such expenses are used to reduce taxable income, a statement similar to that required for administration expenses and losses must be filed. Obviously, the determining factor in the selection of the method of treatment that will be elected is the tax impact; and, once again, computations and forecasts are required.

When a will gives the executor the right to satisfy bequests by distributions in cash or in kind, the executor should weigh the relative tax brackets of the estate and legatees and make such distributions as will produce the least income tax for the group. For example, if certain assets have depreciated in value, the executor can either (1) sell them and take the losses in the estate or (2) distribute them in satisfaction of percentage bequests and permit the legatees to realize the losses. The decision will turn upon one question: Where will the losses produce the greatest tax saving? Here again, the services of an accountant can be helpful in forecasting income levels and making computations.

All of the foregoing elections are interrelated. They all affect either income or estate tax brackets. A computation with respect to any election must take into consideration its effect on other elections which must be made.

At this point a caveat should be sounded. Where income and corpus beneficiaries are identical, no conflict of interest arises when the executor retains income in the estate to minimize the over-all tax burden, or takes advantage of some of the other elections available to him. However, where income and corpus beneficiaries are different persons or share in different percentages, substantial property rights may be involved. Thus, while the accountant can determine the elections which will produce the maximum tax saving, the attorney for the estate should review carefully the legal questions involved. In at least two cases, courts have held that the election by an executor to claim administration expenses on the estate's income tax return, and thus to reduce over-all taxes (because the estate's income tax rate was higher than the estate tax rate) was a permissible exercise of his discretion and that the election could be used to benefit the income beneficiary alone—but not at the expense of the corpus beneficiary. The courts required adjustments restoring to the corpus beneficiaries the amounts by which Federal estate taxes were increased because of the treatment elected.

During the period of the administration of the estate, the last income tax return of the decedent will be due, as well as income tax returns for the surviving spouse, the estate itself, and any testamentary trusts which may have come into being. The accountant is the logical person to prepare these returns, not only because he is the person best qualified to do so, by reason of his skill and training, but also because, in the course of making the

computations and forecasts referred to earlier, he has gathered a substantial portion of the information necessary for the preparation of the returns.

The surviving spouse may file a joint return with the decedent for the year of death. Alternatively, separate returns may be filed. Once again, computations are necessary to determine the better pattern. Testamentary trusts are separate taxable entities. Each trust which comes into being under the will may select its own fiscal year. These fiscal years may be different from those of the beneficiaries, the estate itself, and other trusts. More forecasts and more computations are required.

An estate tax return is due fifteen months from the date of death. This return includes a series of preliminary questions, schedules of assets and deductions, and computations. Both the attorney and the accountant for the estate should begin, immediately after the death of the decedent, to compile all of the information necessary to complete the return. While the "general information" required may appear at first glance to be of relatively minor importance, erroneous answers can cause unnecessary litigation. For example, the answers to the questions relating to the cause of death, length of last illness, decedent's physicians, and hospital in which the decedent was confined during his last illness, can be evidentiary matter if there is any question as to whether or not transfers within three years before the decedent's death were gifts in contemplation of death. The answer to the question, year in which last domicile was established, can have a bearing on whether assets are community or separate property. So also can the answer to the question, date of marriage to surviving spouse. No portion of the return can be treated as unimportant. All questions and schedules must be considered carefully.

The executor may elect to value the assets of the estate either as of the date of death or as of an optional valuation date. The optional date is one year from the date of death unless an asset was disposed of during the year; in this case, such asset is valued as of the date of disposition. If the executor desires to elect the optional valuation date, he must so state in the return. The election, once made, is final and cannot be changed, even though adjustments in values upon examination of the return make a change advantageous.

The values of the decedent's assets as of the date of death or optional valuation date, if it is elected, become their bases for

income tax purposes. This applies not only to those assets upon which an estate tax was paid, but also to those assets which pass tax-free to the surviving spouse under the marital deduction or which already belong to her under the community property laws. Thus, it is not always advisable to select the valuation date which produces the least estate tax. Sometimes, particularly where the beneficiaries are in high income tax brackets and most of the estate assets consist of depletable or depreciable property or inventory, the payment of a higher estate tax can result in a substantial future reduction in income tax with a worthwhile over-all tax saving to the group. Here again, the attorney for the estate must give careful consideration to the property interests involved before such a course can be followed.

Once he has accumulated the substantial amount of material necessary for the preparation of the return, the accountant who is trained by his profession to work with figures, to arrive at valuations, and to schedule assets and liabilities, is well equipped to prepare the estate tax return. On the other hand, the many legal questions involved require a thorough study by the attorney for the estate. Thus, the preparation of the estate tax return should be a joint accountant/attorney undertaking.

After the basis upon which the return will be prepared has been decided at preliminary conferences, the accountant can start the mechanical preparation of the return, making a list of the problems he discovers in the course of his work. Valuations should be prepared both as of the date of death and as of the optional valuation date. He should compute the effect of these valuations on the future income tax liability of the beneficiaries, as well as the difference in estate tax as a result of the selection of the optional valuation date. The tax results of the various elections previously discussed should be scheduled, and suggestions should be made as to the optimum fiscal year. Recommendations should be supported by computations and reasons. All of the above, supported by a memorandum from the accountant setting forth his comments and suggestions, should be turned over to the attorney in sufficient time for him to study the matter properly.

Conferences between the attorney and accountant—and among the attorney, accountant, and executor—should be held whenever necessary. As a result of his study of the material prepared by the accountant, his knowledge of the state and Federal laws involved, his examination of the will, and his conferences with the interested

parties, the attorney should instruct the accountant in writing as to the treatment to be accorded all controversial items. He also should express his agreement generally with the presentation in the draft of the return prepared by the accountant of the items about which there is no question. Acting upon the instructions of the attorney, the accountant should then complete the estate tax return for execution and filing.

As stated before, the attorney and the accountant should work closely in the preparation of the return. They should also work together when the return is examined by the Internal Revenue Service. The accountant usually is in the best position to justify property values, to establish the existence and amount of administration expenses, debts of the decedent, and losses during administration, and to review calculations of tax, including computation of the credit for foreign taxes, determination of the amount of the marital deduction, etc. The attorney, of course, is the only one qualified to resolve any legal questions which may arise.

Little has been said in this discussion about the duties of the executor in connection with the administration of the estate. The executor, of course, bears the prime responsibility for all acts taken; it is the executor who must make all final decisions. When the executor is an individual with little or no experience in the administration of estates, he can be of little assistance to the accountant and attorney and must, perforce, be guided almost entirely by their suggestions. On the other hand when the executor is a bank or trust company whose trust officers are experienced in estate administration, their experience can be of invaluable assistance in arriving at practical solutions to difficult problems.

After the estate tax return has been filed, consideration must be given to winding up the estate. The tax benefits arising from the existence of a separate taxable entity often make it advantageous to keep an estate in existence as long as possible. The law itself contains no criterion as to when an estate must terminate. The Regulations provide that "The period of administration or settlement is the period actually required by the administrator or executor to perform the ordinary duties of administration, such as collection of assets and the payment of debts, taxes, legacies, and bequests, whether the period required is longer or shorter than the period specified under the applicable local law for the settlement of estates." The Regulations provide further that "If the administration of an estate is unreasonably prolonged, the estate is

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considered terminated for Federal income tax purposes after the expiration of a reasonable period for the performance by the executor of all the duties of administration." There has been a substantial amount of litigation on the question of whether, in a particular case, the delay has been unreasonable, so that the period of administration has come to an end for tax purposes. If it has, the legatees may be required to treat the income as their own. The accountant should prepare all figures necessary to plan for the closing out of the estate, considering the most beneficial time within the test of reasonableness contained in the Regulations. Such planning should include consideration of possible advantages to beneficiaries of the carry-over of losses generated in the last year of the administration of an estate, the timing of the payment of final administration expenses, etc.

Other computations which should be made by an accountant include those relating to the tax treatment of income with respect to a decedent, those arising from the inclusion in an estate of previously taxed property and those necessary to determine if the estate is eligible for special treatment because stock in a closely held corporation equals 35 per cent of the gross estate or 50 per cent of the taxable estate.

There is a cash problem in many estates. A cash budget and forecast prepared by the accountant can simplify the task of the executor in taking care of the cash needs of the beneficiaries and maintaining the liquidity of the estate. Such a budget would provide for the liquidation of assets at such times as would produce the maximum tax benefit and the least sacrifice of investment income, consistent with providing the funds needed by the estate to take care of debts, expenses, and distributions to beneficiaries.

When the administration of the estate has been concluded, the estate tax return has been accepted by the Government, and the executor or administrator is about to be discharged, the accountant can prepare a final accounting for the executor to submit to the beneficiaries and, if necessary, the probate court. Thereafter, if trusts have been established under the will of the decedent, the accountant can make annual audits of the trusts, reviewing the distribution of receipts between income and corpus and the allocation of income among various beneficiaries.

Thus, from the date of the decedent's death until the estate final accounting is prepared, there are records to be set up, computations and forecasts to be made, tax returns to be filed, and financial statements to be prepared. All of this is accounting work which should be done by an accountant.

Reorganization of Management Services

Report on the Reorganization of Management Services

The Executive Committee has recently announced that, effective April 1, all management services capabilities and functions of the Firm, other than the Management Services Research and Consulting Division, will be reorganized on a regional basis. Four regions have been established, each headed by a Director who will be responsible in administrative matters to an Administrative Partner designated by the Executive Committee, and functionally to the Chairman of the Management Services Committee.

The designation of key personnel in the four regions, effective April 1, is as follows:

Northeast Region

Administrative Partner . . . Hilton R. Campbell
Regional Director Felix Kaufman

Southeast Region

Administrative Partner . . . George A. Hewitt
Regional Director James E. Meredith, Jr.

Central Region

Administrative Partner . . . John C. Potter
Regional Director John J. O'Donnell, Jr.

Western Region

Administrative Partner . . . Robert S. Warner
Regional Director Maurice B. T. Davies

Mr. Herman C. Heiser will continue to serve as Chairman of the Management Services Committee.

Standards of Education and Experience for C.P.As*

By Dr. Frank P. Smith (Director of Education and Personnel)

There have been three significant and related events in the past three years which are of concern to accounting practitioners and educators. The first event was the publication in August 1956 of the report of the Commission on Standards of Education and Experience for Certified Public Accountants.¹ The second was the report to Council of the American Institute of Certified Public Accountants, in April 1959, prepared by a special committee appointed to consider the Commission's report. The third event was a series of resolutions adopted by the Council of the A.I.C.P.A. on April 22, 1959.²

Background of the Commission

The Commission on Standards of Education and Experience for Certified Public Accountants was organized in April 1952. This important step was the culmination of many years of effort by individuals and committees "... to bring about more uniform and more realistic standards for the qualification of C.P.As."³

An important factor to recognize in appraising the Commission's recommendations is that it was organized as a separate and independent entity and was in no sense a part of any other existing accounting organization. This position of independence resulted from the decision of a group representing the American Institute of Certified Public Accountants, the American Accounting Association, the American Association of Collegiate Schools of Business, the Association of C.P.A. Examiners and the Board of Examiners of the American Institute of Certified Public Accountants, which met on April 18, 1952 and approved the organization and general plan for the Commission. Every effort was made in the formation

* Reprinted by permission from *The New York Certified Public Accountant*, November, 1959, pp. 789-797.

¹ Published by the Bureau of Business Research, University of Michigan, Ann Arbor, 1956.

² For the sake of brevity, these organizations will be referred to as "Commission," "Committee" and "Council."

³ Commission Report, p. v.

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of the Commission, in selecting members, and in the conduct of its investigation to preserve an objective and unbiased point of view.

The Commission's recommendations were divided into "long-range" and "transitional" goals. The A.I.C.P.A. did not distinguish between short-range and long-range objectives, and this creates some difficulty in comparing or reconciling its actions with the recommendations of the Commission. However, it should be noted that the points of view of the two organizations were basically different in terms of the timing of potential developments. The report of the Commission ". . . is an attempt (a) to provide the background for an appraisal of present requirements and practices, and (b) to formulate standards of education and experience for C.P.As which are adequate to meet the *prospective* needs of the public and of the profession and which are also reasonably possible of attainment in the *foreseeable* future."⁴ The emphasis throughout the Commission's report was on the future, on what standards should be established now as goals to be attained in later years. In contrast, and understandably, the A.I.C.P.A. is more concerned with what can be done today and in the immediate future.

The Special Committee

The Commission's report was considered by the Council of the A.I.C.P.A. in 1956. "The Commission Report received extensive discussion . . . and while it was recognized that there were controversial points, particularly in respect to the professional practice of public accounting, Council believed the Report set forth many areas in which the Institute could promote the findings and recommendations and that the Institute should do so where it could."⁵

The Executive Committee of the A.I.C.P.A. authorized the appointment of a special committee to study the Commission's report and to report to Council. The following individuals were appointed as members in 1957:

George D. Bailey, Chairman (Touche, Niven, Bailey & Smart).

William H. Holm (I. D. Wood & Co.).

C. A. Moyer (College of Commerce, University of Illinois).

John C. Potter (Lybrand, Ross Bros. & Montgomery).

T. Dwight Williams (Williams, Hurst & Groth).

⁴ Commission Report, p. ix. Emphasis added.

⁵ Committee Report, p. 1.

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This committee was given the following assignment:

1. to make a comprehensive and methodical study of the Commission Report.
2. To consult with groups both within and outside of the A.I.C.P.A. having an immediate interest in the report as to recommendations made by the Commission and the policies in implementing them.
3. To suggest to the A.I.C.P.A. Council what action, if any, should be taken on the Commission's recommendations.

The Committee studied the Commission's report and obtained opinions of many interested and informed individuals including members of the Commission; committee members or official representatives of the A.I.C.P.A., the American Accounting Association, the National Association of Accountants, the American Association of Collegiate Schools of Business and the S.E.C.; the Comptroller General of the United States; practicing C.P.A.s; members of boards of accountancy; accounting educators; university administrators; and industrial accountants. This study was exhaustive and objective.

The Committee reported to the Council of the A.I.C.P.A. in April 1959: "It is believed that the Institute should not attempt to approve or disapprove any parts of the Commission Report, but it is within the province of the A.I.C.P.A. to determine which of the recommendations of the Commission could be adopted *at this time* by the Institute as part of its own policies and programs, and to implement those adopted."⁶

The Committee's recommendations and the Council's resolutions covered thirteen points. In contrast, the Commission had five basic recommendations and three recommendations for the transitional period. However, substantially the same points are covered in total; in the following discussion the framework of the Committee's report will be followed.

Meaning of the C.P.A. Certificate

The meaning of the C.P.A. certificate is not one of the Commission's "recommendations." However, the majority of the members of the Commission concluded that the C.P.A. certificate should come to be regarded as a standard of competence, acquired principally through the educational process, ". . . to enter the profession of public accountancy as C.P.As."⁷ This conclusion

⁶ Committee Report, p. 1. Emphasis added.

⁷ Commission Report, p. 126. Emphasis added.

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is basic to the long-range goals recommended by the Commission and was properly included in the thirteen points covered by the Committee.

The Committee recommended, and the Council concurred, ". . . that the long established meaning of the C.P.A. certificate as evidence of demonstrated competence for the practice of public accounting be continued; . . ." The Committee also recommended, ". . . that the Commission's conclusion as to the meaning of the C.P.A. certificate as a mark of competence, obtained through the formal educational process, to enter the profession of public accountancy not be adopted as Institute policy."⁸

This is one of the principal points in which the Committee's decision to ignore the Commission's distinction between short-run and long-run goals creates difficulties in comparing the two sets of recommendations. The Commission did conclude, as the Committee states, that the C.P.A. certificate should be regarded as a mark of competence obtained through the formal educational process *but only as a long-range proposal*. Such dependence on the educational system is contingent upon developments in that field. This is clearly stated in the Report:

The formal educational preparation of candidates for the profession needs to be much more advanced than that now required by most accountancy legislation and, in fact, more thorough and comprehensive than is now provided by most educational institutions. Such preparation is far more crucial to the matter of qualification for practice than was true when the scope of public accounting services was relatively narrow. It should be feasible for C.P.A. jurisdictions to set standards of formal education and to evaluate educational achievements through an examination. Accordingly, *from the long-run point of view*, the Commission feels that increased reliance must be placed on educational training.⁹

The Commission recommended the continuance of an experience requirement for the *transitional period*, which seems to be entirely in harmony with the "approval" portion of the Council's resolution. This point is covered in more detail in the Committee's recommendation relating to experience.

College Graduation

The Commission recommended that "College graduation, including completion of an accounting major as part of the undergraduate program, or college graduation, supplemented by

⁸ Committee Report, p. 6.

⁹ Commission Report, p. 127. Emphasis added.

completion after graduation of the equivalent of an accounting major, . . .” is a desirable standard for C.P.As in the *transitional period*.¹⁰ The Committee and the Council concurred with this general recommendation and also with the earlier recommendations of the Standards Rating Committee of the American Accounting Association, regarding curricula, which were mentioned favorably by the Commission.

Considering the diversity of educational requirements today among the many C.P.A. jurisdictions, the recommendations of the Committee and the resolution of the Council favoring the possession of a baccalaureate degree as a requirement for the preparation of a C.P.A. are probably the most significant of the actions taken.

Qualifying Examination

This long-range recommendation of the Commission is related to another—that postgraduate study of a professional nature is needed to provide adequate preparation for public accountancy as a C.P.A. The suggested qualifying examination “. . . would provide a measure of each candidate’s intellectual capacity, his academic achievements through prior study, and his aptitude for public accountancy, in terms of nation-wide objective norms. The primary purpose of the examination is to assist educational institutions in selecting individuals who have the capacity and aptitude to undertake, with benefit, the training to be provided through the proposed professional programs.”¹¹

The Committee reported that “The qualifying examination may eventually be a problem warranting considerable attention as the Commission suggests.”¹² In the meantime, the Committee recommended “no action” by the Council with the related suggestion that the Committee on Personnel Testing consider the testing program of the A.I.C.P.A. in relation to the possible need of a qualifying examination for postgraduate study as preparation for a career in public accounting.

The Commission suggested that the Committee on Accounting Personnel of the A.I.C.P.A. “. . . would be an appropriate body . . .” to undertake the responsibility for developing the qualifying examination.¹³ The difference between the position of the A.I.C.P.A.

¹⁰ Commission Report, p. 137.

¹¹ Commission Report, p. 129.

¹² Committee Report, p. 11.

¹³ Commission Report, p. 130.

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and the Commission is principally one of timing. In 1956, there were few academic programs which approximated the postgraduate educational program of a professional nature which the Commission envisaged and consequently there was no immediate need for a qualifying test. The Commission anticipated that such academic programs would develop and that the test would eventually be needed.

A number of postgraduate and five-year undergraduate programs in professional accountancy have been adopted during the past three years and more are being considered. It is at least possible that the need for a qualifying examination may be more immediate than the A.I.C.P.A. concluded last April.

Postgraduate Education for Public Accounting

The Commission recommends "... the establishment of professional academic programs . . . designed to train individuals for public accountancy . . ." and also recommended completion of such a program as one of its long-range goals for C.P.As.¹⁴ With the exception of a few programs which have been developed recently, this type of academic preparation is not available to aspiring C.P.As.

The A.I.C.P.A. recognized both the value of the type of postgraduate training which the Commission recommended and the fact that opportunities for such preparation are not generally available. The resolution of the Council reads as follows: "That postgraduate education for careers in public accounting is desirable and that as soon as it is feasible postgraduate study devoted principally to accountancy and business administration become a requirement for the C.P.A. certificate."¹⁵ The A.I.C.P.A. also related professional postgraduate education to the experience requirement. This is discussed later under the heading of "Experience."

Assistance to Accrediting Agencies

Accreditation in any field is a controversial issue, particularly when it is interjected into one in which there has been so much activity. The purpose of accreditation is to preserve or to elevate standards. The Commission suggested the need for accreditation of the postgraduate programs of professional nature which it considered a necessary part of the preparation of C.P.As as a long-

¹⁴ Commission Report, p. 130.

¹⁵ Minutes of Council, pp. 40-41.

range goal. The Commission also suggested that the A.I.C.P.A. was the appropriate body to bring interested groups together to form an accrediting organization which should be "... established on a nation-wide basis, be operationally independent of any accounting organizations, and reflect the viewpoints of both educators and practitioners."¹⁶ The Committee opposed this step and instead recommended, and the Council concurred: "... that an advisory committee of the A.I.C.P.A. preferably acting in co-operation with representatives from the American Accounting Association, and the American Association of Collegiate Schools of Business, be formed to assist interested schools in planning and revising courses and programs for educating accountants and to assist existing accrediting agencies and associations in evaluating accounting courses and curriculums."¹⁷

The reference to existing accrediting agencies and associations is vague—there are no national or regional accrediting organizations, to the writer's knowledge, which are specifically or even particularly interested in accounting courses or programs. However, the suggestion of a group selected from the membership of the A.I.C.P.A., the A.A.A. and the A.A.C.S.B. to assist in developing courses and programs has merit and would probably be welcomed by those schools which are struggling with the general problem of overhauling curriculums and developing postgraduate education in accountancy. Such a step might well be the forerunner of a more formal organization; it also offers the possibility of achieving many of the desirable features of accreditation with a minimum of involvement in the controversial issues which surround this phase of education. The Committee's comment "For the next several years the problem will not be one of accrediting but one of counseling and planning with educators about new courses ..." is quite appropriate.¹⁸

Student Internship

The idea of student internships should be a simple matter but it proved to be a confusing issue during the preparation of the Commission's report; it was one of the issues involved in the dissents of two members of the Commission and the action of the A.I.C.P.A. is not clear in relation to the Commission's recommendations.

¹⁶ Commission Report, p. 134.

¹⁸ Committee Report, p. 14.

¹⁷ Committee Report, p. 7.

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The Commission's position is that "... some exposure to actual accounting operations and procedures [is considered] to be a highly desirable part of the formal education of an individual interested in public accountancy..."¹⁹ and suggests the desirability of an internship program during the proposed postgraduate professional program. The Commission recognized that a number of problems are associated with internships and suggested that they be "... established on a voluntary basis."²⁰

The resolution of the Council reads as follows: "That student internship as a part of the student's educational program be optional; that plans be developed by a committee of the A.I.C.P.A. so that internships may be well organized and carefully supervised by schools and practitioners when used; and that serious effort be made toward answering the problem of whether internships should be provided to all who qualify."

Presumably the words "voluntary" in the Commission's report and "optional" in the Council's resolution have the same meaning. On other counts the two statements do not seem to be very close. There is acceptance of the idea of internships in the Committee's discussion: "Carefully planned and closely supervised student internship programs do furnish definite educative experience to participants who have the capacity for benefiting from such experience and provide an element of screening."²¹ The "screening" factor was not included in the Commission's considerations; the Commission assumed that most, if not all, of the necessary screening would be accomplished by means of the qualifying examination, admission to postgraduate accountancy programs and performance in those programs.

It is possible that the A.I.C.P.A.'s emphasis on problems which might be associated with internships may be due to its concern with the short-range point of view and to the numbers of potential interns who might be expected from existing undergraduate programs.

The suggestion that "... plans be developed by a Committee of the A.I.C.P.A. . . ." for internships has already been attempted. Committees of the A.I.C.P.A. and of the American Accounting Association prepared a joint statement on this subject.²² Perhaps

¹⁹ Commission Report, p. 135.

²⁰ *Ibid.*

²¹ Committee Report, p. 15.

²² This report was published in the April, 1955, issues of *The Accounting Review*, pp. 206-10, and *The Journal of Accountancy*, pp. 74-76.

the Council included its reference to plans to be developed for internships on the ground that a more elaborate statement is needed.

Experience

The question of experience in public accounting as a requirement for the C.P.A. certificate has been the most hotly debated point in the Commission's report and was the principal reason for the four dissents. It should be noted that these dissents relate principally to the long-range recommendations of the Commission which, in turn, are based upon the proposed "new meaning" of the C.P.A. certificate and are directly contingent upon the evolution of postgraduate education of a professional nature.

The Commission recommended for the *transitional period*: "A minimum of two years of practical experience in public accountancy under the guidance of a C.P.A."²³ The resolution of Council is broader than this recommendation and, in one respect, is broader than the recommendation of the Committee. The resolution includes five points which are considered separately.²⁴

(a) "That an experience requirement be retained;..." This is comparable to the Commission's recommendation for the transitional period.

(b) "... that with the baccalaureate degree with or supplemented by evidence of study of accounting to the extent set forth in resolution 2 [see previous discussion on "College Graduation"] the experience be not less than two years;..." This point does not appear in the Committee's recommendations; it is comparable to the Commission's recommendation for the transitional period.

(c) "... that as education is extended beyond the baccalaureate degree the length of experience should be reduced but should not be less than one year;..." This wording is comparable to the Committee's recommendation and goes part of the way towards the Commission's long-range goals.

(d) "... that the experience should be under the guidance of a C.P.A. and some of the experience should be in the area of third-party reliance;..." The Commission's recommendations agree with this for the transitional period although experience "in the area of third-party reliance" is not a specific point. This is an appropriate requirement if reliance on experience is to be continued.

(e) "... that a committee of the A.I.C.P.A. should prepare a statement as to what, in general, should be an acceptable type of experience for the C.P.A. certificate." This statement is consistent with the Commission's discussion of experience in the transitional period.

The Council's recommendation of two years of experience represents a middle position between those jurisdictions which

²³ Commission Report, p. 137.

²⁴ Minutes of Council, pp. 41-42.

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require none, or waive experience if certain educational requirements are met, and those which require three years or more according to the classification of the candidate's employer. The requirement that the minimum experience be obtained under the guidance of a C.P.A., and some be in the area of third-party reliance, is more stringent than many laws and regulations currently in effect. The recommendation that the minimum experience requirement be reduced if certain educational standards are met is consistent with the trend in many jurisdictions in recent years.

The C.P.A. Examination; Timing of the Examination

The Council's resolution incorporates the principal recommendation of the Committee, "... that the existing purposes and level of the C.P.A. examination be continued."²⁵ The Committee recommended further, "... that the Commission recommendation that the compilation and grading of the examination should be pointed solely toward testing the results of academic preparation not be adopted by the Institute."²⁶ The point involved here is a difference of opinion regarding the level and purpose of the examination.

The position of the Commission is that "The present examination is largely academic in type and nature and there is little content in recent examinations for which preparation could not have been effectively made through educational training."²⁷

The Committee referred, in its report, to the position of the Board of Examiners that, "The level of the examination has been the competence required for conducting the medium-sized engagement or for general practice in a medium-sized community."²⁸ The Committee added, further, that "The purpose of the C.P.A. examination has been to measure technical competence, which includes technical knowledge, skill in the application of such knowledge and the exercise of good judgment."²⁹ These two statements surely imply that experience in public accounting is a necessary prerequisite to sit for the examination. Yet the resolution of the Council relating to the timing of the examination provides "That a candidate be permitted to take the examination when he feels adequately prepared, but not before he has successfully completed

²⁵ Minutes of Council, p. 42.

²⁸ Committee Report, p. 8.

²⁶ Committee Report, p. 8.

²⁹ *Ibid.*

²⁷ Commission Report, p. 122.

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the recommended educational requirements."³⁰ The Commission's position is consistent with this resolution.

Awarding the C.P.A. Certificate

The Committee recommended, and the Council concurred, "That the C.P.A. certificate be awarded after the candidate has successfully completed the examination and experience requirement."³¹ This is identical with the Commission's recommendation for the transitional period.

The Committee also included the following sentence in its recommendation: "In this recommendation our Committee disagrees with the Commission which did not recommend experience as a requirement."³² Again, the failure to observe the Commission's distinction between short- and long-run proposals causes difficulty. The Commission *did* recommend experience for the transitional period and its recommendation is identical with the resolution of the Council relating to experience. It is in the long-range proposals that the Commission combined the extension of professional education on a postgraduate basis (including a period of internship in public accounting), accreditation of programs, and qualifying examinations, with the elimination of the experience requirement for the certificate.

Other Considerations

Assistance to Colleges. The Commission mentioned the need for faculties with experience in public accounting and for classroom materials drawn from practice. The Council's resolution is much broader. It includes, in addition, recommendations of financial assistance and special lecturers for schools of business.

Timing State Legislative Changes. The Council concludes, most appropriately, that State society committees concerned with legislation should consider local conditions. The Commission made no recommendation on this matter but it did recognize the effects of local conditions upon past and present requirements of education and experience for C.P.As.³³

Review of the Problem. The Council recommended, "That the A.I.C.P.A. take the leadership in causing periodic reviews of education and experience for C.P.As."³⁴ The Commission made no recommendation on this point but the action of the A.I.C.P.A. is entirely in harmony with the spirit of the Commission's report.

³⁰ Minutes of Council, p. 42.

³¹ *Ibid.*

³² Committee Report, p. 9.

³³ Commission Report, pp. 37-38.

³⁴ Minutes of Council, p. 42.

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Reciprocity for Experience and Examination. There were two points covered in the discussion portion of the report of the Committee which were not covered in the Council's resolutions.³⁵ These were:

1. A state board should consider acceptable experience obtained in other jurisdictions and should not insist that experience be acceptable only if acquired in the particular jurisdiction.

2. There should be reciprocity among jurisdictions using the advisory grading service of the Institute for completed parts of the examination. These points are to be considered at a later meeting of Council.

Summary

The position of the A.I.C.P.A. regarding the meaning of the certificate reflects the general idea held by many C.P.As including the four dissenters to the Commission report. The certificate is considered an indication of competence to practice which must be obtained in part through experience. This is not compatible with many of the accountancy laws and regulations but the point is not of great moment at this time. The recommendation that experience should be obtained under the direction of a C.P.A., that part of it should be in the area of third-party reliance, and that the A.I.C.P.A. should describe what is acceptable experience, are important steps designed to put real meaning into the experience requirement.

The Council's resolutions regarding educational requirements are significant. Recognition of the importance of undergraduate education for C.P.As, and the recommendations that postgraduate education might be substituted in part for experience, and that candidates be admitted to the C.P.A. examination, after completing educational requirements, are important steps.

The report of the Committee is a most interesting document, aside from the specific recommendations. The discussion of the thirteen areas is worth careful reading by anyone interested in standards for C.P.As. The firm, practical positions taken by the Council should do much to clarify many of the ambiguous and controversial aspects of C.P.A. requirements and should give a tremendous impetus to the movements under way in many jurisdictions to obtain more realistic standards of education and experience for C.P.As.

³⁵ Minutes of Council, p. 43. These points were presented by Louis M. Kessler.

What Price Progress*

In discussing the costs incident to various types of operations, the analogy was drawn of the Restaurant which adds a rack of peanuts to the counter, intending to pick up a little additional profit in the usual course of business. This analogy was attacked as an oversimplification. However, the accuracy of the analogy is evident when one considers the actual problem faced by the Restaurateur (Joe) as revealed by his Accountant-Efficiency-Expert.

EFF EX: Joe, you said you put in these peanuts because some people ask for them, but do you realize what this rack of peanuts is *costing* you?

JOE: It ain't gonna cost. 'Sgonna be a profit. Sure, I hadda pay \$25 for a fancy rack to hold a bags, but the peanuts cost 6¢ a bag and I sell 'em for 10¢. Figger I sell 50 bags a week to start. It'll take 12½ weeks to cover the cost of the rack. After that I gotta clear profit of 4¢ a bag. The more I sell, the more I make.

EFF EX: That is an antiquated and completely unrealistic approach, Joe. Fortunately, modern accounting procedures permit a more accurate picture which reveals the complexities involved.

JOE: Huh?

EFF EX: To be precise, those peanuts must be integrated into your entire operation and be allocated their appropriate share of business overhead. They must share a proportionate part of your expenditures for rent, heat, light, equipment depreciation, decorating, salaries for your waitresses, cook, —

JOE: The *cook*? What's a he gotta do wit'a peanuts? He don' even know I got 'em!

EFF EX: Look, Joe, the cook is in the kitchen, the kitchen prepares the food, the food is what brings people in here, and the people ask to buy peanuts. *That's* why you must charge a portion of the cook's wages, as well as a part of your own salary to peanut sales. This sheet contains a carefully calculated costs analysis which indicates the peanut operation should pay exactly \$1,278 per year toward these general overhead costs.

JOE: The peanuts? \$1,278 a year for overhead? The nuts?

EFF EX: It's really a little more than that. You also spend money each week to have the windows washed, to have the place swept out in the mornings, keep soap in the washroom and provide free cokes to the police. That raises the total to \$1,313 per year.

JOE: (Thoughtfully) But the peanut salesman said I'd make money—put 'em on the end of the counter, he said—and get 4¢ a bag profit—.

* *Editor's Note:* We have been unable to locate the source of this paper. If any of our readers can provide us with this information, we shall be delighted to acknowledge our indebtedness.

What Price Progress

- EFF EX: (With a sniff) He's not an accountant. Do you actually know what the portion of the counter occupied by the peanut rack is worth to you?
- JOE: Ain't worth nothing—no stool there—just a dead spot at the end.
- EFF EX: The modern cost picture permits no dead spots. Your counter contains 60 square feet and your counter business grosses \$15,000 a year. Consequently, the square foot of space occupied by the peanut rack is worth \$250 per year. Since you have taken that area away from general counter use, you must charge the value of the space to the occupant.
- JOE: You mean I gotta add \$250 a year more to the peanuts?
- EFF EX: Right. That raises their share of the general operating costs to a grand total of \$1,563 per year. Now then, if you sell 50 bags of peanuts per week, these allocated costs will amount to 60¢ per bag.
- JOE: WHAT?
- EFF EX: Obviously, to that must be added your purchase price of 6¢ per bag, which brings the total to 66¢. So you see, by selling peanuts at 10¢ per bag you are losing 56¢ on every sale.
- JOE: Somethin's crazy!
- EFF EX: Not at all! Here are the *figures*. They *prove* your peanut operation cannot stand on its own feet.
- JOE: (Brightening) Suppose I sell *lotsa* peanuts—thousand bags a week 'stead a fifty?
- EFF EX: (Tolerantly) Joe, you don't understand the problem. If the volume of peanut sales increases, your operating costs will go up—you'll have to handle more bags, with more time, more depreciation, more everything. The basic principle of accounting is firm on that subject: "The Bigger the Operation the More General Overhead Costs that Must be Allocated." No, increasing the volume of sales won't help.
- JOE: Okay. You so smart, *you* tell *me* what I gotta do.
- EFF EX: (Condescendingly) Well—you could first reduce operating expenses.
- JOE: How?
- EFF EX: Move to a building with cheaper rent. Cut salaries. Wash the windows bi-weekly. Have the floor swept only on Thursday. Remove the soap from the washrooms. Decrease the square foot value of your counter. For example, if you can cut your expenses 50%, that will reduce the amount allocated to peanuts from \$1,563 down to \$781.50 per year, reducing the cost to 36¢ per bag.
- JOE: (Slowly) That's better?
- EFF EX: Much, much better. However, even then you would lose 26¢ per bag if you charge only 10¢. Therefore, you must also raise your selling price. If you want a net profit of 4¢ per bag you would have to charge 40¢.

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- JOE: (Flabbergasted) You mean even after I cut operating costs 50% I still gotta charge 40¢ for a 10¢ bag of peanuts? Nobody's that nuts about nuts! Who'd buy 'em?
- EFF EX: That's a secondary consideration. The point is, at 40¢ you'd be selling at a price based upon a true and proper evaluation of your then reduced costs.
- JOE: (Eagerly) Look! I gotta better idea. Why don't I just throw the nuts out—put 'em in a ash can?
- EFF EX: Can you afford it?
- JOE: Sure. All I got is about 50 bags of peanuts—cost about three bucks—so I lose \$25 on the rack, but I'm outa this nutsy business and no more grief.
- EFF EX: (Shaking head) Joe it isn't quite that simple. You are *in* the peanut business! The minute you throw those peanuts out you are adding \$1,563 of annual overhead to the *rest* of your operation. Joe—be realistic—*can you afford to do that?*
- JOE: (Completely crushed) It'sa unbelievable! Last week I was a make money. Now I'm in a trouble—justa because I think peanuts on a counter is a gonna bring me some extra profit—justa because I believe 50 bags of peanuts a week is a easy.
- EFF EX: (With raised eyebrow) That is the object of modern cost studies, Joe—to dispel those false illusions.
-

Report on Client Courses in EDP

By Mona Hersh

(Management Services Research and Consulting Division)

The Management Services Research and Consulting Division has conducted several courses for clients on various aspects of electronic data processing. Two of these will be of particular interest to personnel of the Firm.

The first course to be mentioned was conducted for the systems and procedures personnel of a client by Dr. Michael Shegda. The course covered basic EDP planning concepts involving the survey and implementation phases of a computer installation and a hypothetical case study which was used to illustrate systems and flow charting techniques.

The second course was presented to several members of a large European manufacturing concern, and included the following topics:

1. The feasibility of electronic data processing;
2. Analysis of Methods employed in planning an EDP system;
3. Analysis and evaluation of Integrated Data Processing;
4. Effects of EDP on internal control;
5. Implementation of internal control;
6. Effect of EDP on audit trail arrangements;
7. Significance of a computer for the audit;
8. Impact on the auditor.

The principal features of the discussions during the course were the points of similarity and difference between European and American solutions of EDP problems.

Recent Library Acquisitions

By Dorothy Kasman (New York Office)

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- Business operations in France; a guide for American investors. Comite Franc-Dollar. April 1959.
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Speaking Engagements

| <i>Date</i> | <i>Speaker</i> | <i>Organization</i> | <i>Topic</i> |
|-------------|---|--|---|
| Oct. | | | |
| 2 | Kenneth P. Johnson, Pittsburgh | Pennsylvania Institute of C.P.A.s, Pittsburgh Chapter | Technical Session |
| 2 | John J. McCullough, Detroit | West Virginia Tax Institute | The DuPont Case |
| 2 | Thomas J. Snowden, St. Louis | N.A.A. St. Louis Chapter | State and Local Taxes |
| 2 | G. W. Welsch, Dallas | Abilene Life Underwriters Estate Planning Conference | Income Tax Aspects of Estate Planning |
| 5 | T. Hayes Anglea, Los Angeles | National Conference of Health and Welfare Plans Trustees and Administrators | Investments and Reserves |
| 5 | James E. Meredith, Jr., Philadelphia | American Association of Hospital Accountants | A C.P.A. Looks at Hospital Accounting |
| 9 | J. Walker Voris, Los Angeles | California Society of C.P.A.s, Los Angeles Chapter, Third Annual Systems Seminar | Automatic Data Processing |
| 12 | H. O. Reyburn, Tulsa | American Association of Nurserymen | The New Tax Law |
| 13 | George H. Kern, Chicago | Albany Park Lions Club | What To Do When the Revenue Agent Calls |
| 13 | M. E. Richardson, New York | Joint Meeting of Maryland Society of C.P.A.s and D. C. Institute of C.P.A.s | Standards of Responsibility of C.P.A.s in Tax Practice |
| 15 | Burton E. Lindgren, Rockford | Illinois Society of C.P.A.s, Northern Chapter | Panel Discussion—Tax Problems of Closely Held Corporations |
| 16 | Norman E. Auerbach, New York | University of Michigan, School of Business Administration | Tax Practice in a Public Accounting Firm |
| 16 | Fred Boas, Jr., M.S.R. & C.D. | N.A.A. Lancaster Chapter | Streamlining Accounting Pro- cedures for Automation |
| 17 | Joseph E. Tansill, Chicago | 41st Annual Meeting of Foundry Equipment Manufacturers Association Inc. | Panel Presentation—Tax Depre- ciation of Foundry Equipment |
| 19 | William R. Hindman, Louisville | Kentucky Society Management Services Study Course, Bellarmine College | Discussion Leader—Budgeting |
| 19 | Paul S. Lovoi, Tulsa | Tulsa Association of Air Condition- ing and Refrigeration Contractors | Tips on Taxes |
| 19 | Louis H. Rappaport, New York | Florida Society of C.P.A.s | Filings for S.E.C. |
| 19 | Lambert H. Spronck, San Francisco | Institute of Newspaper Controllers and Finance Officers | Preparing and Using Newspaper Financial Projections |
| 19 | G. W. Welsch, Dallas | Texas Tech Annual Tax Conference | Subchapter S |
| 20 | James E. Meredith, Jr., Philadelphia | N.A.A. Rockford Chapter | Organizing for Systems Study |
| 20 | H. O. Reyburn, Tulsa | N.A.A. Tulsa Chapter | Tax Planning Is Tax Savings |
| 20 | Frank P. Smith, New York | N.A.A. Cedar Rapids Chapter | The Accountant and His Managerial Future |
| 21 | Norman E. Auerbach, New York | New York State Society of C.P.A.s | Pension and Profit Sharing Plans |

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|-------------|---|---|--|
| Oct. | | | |
| 21 | Raymond E. Graichen, Philadelphia | Tax Executives Institute, Inc. | Accounting Method Changes |
| 21 | Herman C. Heiser, M. S. R. & C. D. | N.A.A. Brooklyn Chapter | Integrated Data Processing |
| 21 | William J. Holland, Philadelphia | Berks County Industrial and Time Study Engineers | Production Control |
| 22 | J. Wesley Huss, San Francisco | California Society of C.P.A.s, San Joaquin Chapter | Legislative Program in California |
| 23 | James E. Meredith, Jr., Philadelphia | N.A.A. Lehigh Valley Chapter, Allentown | Direct Costing |
| 26 | Felix Kaufman, M. S. R. & C. D. | N.A.A. Detroit Chapter | Organizational Problems in the Processing of Data |
| 27 | Bill Goodner, Birmingham | Alabama Association of Public Accountants | Tax Option Corporations |
| 28 | Joseph F. McCarthy, Jr., Pittsburgh | University of Pittsburgh | Case Studies in Standard Costs |
| Nov. | | | |
| 2 | Louis S. Sorbo, Louisville | Kentucky Society—Management Services Study Course, Bellarmine College | Fringe Benefits |
| 5 | John J. O'Donnell, Jr., New York | N. Y. State Society of C.P.A.s | Punched Card Accounting and Its Auditing Applications |
| 6 | J. Wesley Huss, San Francisco | Nevada Society of C.P.A.s Annual Meeting | A Report from the American Institute |
| 10 | Joseph E. Tansill, Chicago | N.A.A. Lake Superior Chapter, Duluth | Recent Developments in State Taxation |
| 12 | Raymond E. Graichen, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | The Tax Function in Public Accounting |
| 12 | Robert S. Haas, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | Moderator of Panel Discussion |
| 12 | Frank P. Smith, New York | West Virginia University | Trends in Accounting Education |
| 12 | Herman Stuetzer, Jr., Boston | New York University Institute on Federal Taxation | Valuing Business Interests of a Decedent—The Implications of Rev. Rul. 59-60 |
| 12 | Arthur Yaspan, M. S. R. & C. D. | Cowles Foundation Management Seminar, Yale University | Inventory Policies |
| 13 | Harold W. Glore, Louisville | Kentucky Society Institute on Accounting | Chairman of Session |
| 13 | Fred G. Herr, M. S. R. & C. D. | A.M.A., New York | Ultimate in Production Control |
| 13 | Robert L. Jessee, San Francisco | California Society of C.P.A.s 10th Annual Tax Accountants Conference | Panel Member—Problems Arising on the Preparation of Fiduciary Income Tax Returns |
| 13 | M. E. Richardson, New York | California Society of C.P.A.s 10th Annual Tax Accountants Conference | Recent Developments in Federal Income Taxation |
| 16 | Fred G. Herr, M. S. R. & C. D. | Business Electronics Roundtable, New York | The Production Control Application |
| 16 | Felix Kaufman, M. S. R. & C. D. | Business Electronics Roundtable, New York | Outside Views of E.D.P. |
| 16 | John J. O'Donnell, Jr., New York | New York University Graduate School of Business Administration | Accounting Machinery |

Speaking Engagements

| <i>Date</i> | <i>Speaker</i> | <i>Organization</i> | <i>Topic</i> |
|-------------|--|--|--|
| Nov. | | | |
| 17 | Philip L. Defliese, New York | North Carolina Association of C.P.A.s | Internal Control and Its Significance in Auditing |
| 17 | J. Paul Finnegan, Boston | Massachusetts Society of C.P.A.s | Recent Developments in the Mass- achusetts Corporation Excise |
| 17 | Robert L. Jessee, San Francisco | California Society of C.P.A.s 10th Annual Tax Accounting Conference | Panel Member—Problems Arising on the Preparation of Fiduciary Income Tax Returns |
| 17 | William H. Lundquist, Philadelphia | N.A.A. North Pennsylvania Chapter, Norristown | Coordinating Responsibility to Effect Inventory Control |
| 17 | James E. Meredith, Jr., Philadelphia | N.A.A. Omaha Chapter | Direct Costing |
| 17 | Edward P. Mullen, Philadelphia | N.A.A. North Pennsylvania Chapter, Norristown | Inventory Valuation |
| 17 | M. E. Richardson, New York | California Society of C.P.A.s 10th Annual Tax Accounting Conf. | Recent Developments in Federal Income Taxation |
| 18 | Donald E. Beattie, Dallas | N.A.A. Dallas Chapter, Discussion Forum | Direct Costing—A Tool of Management |
| 18 | William B. Keast, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter, for students at IBM Corporation | Auditing of Punched Card and Electronic Data Processing Systems |
| 18 | Stanley E. Walker, Cincinnati | Mt. Healthy High School | Panel Member—Vocational Guidance Conference |
| 19 | Dr. Tibor Fabian, Herman C. Heiser, Felix Kaufman, M. S. R. & C. D. | N.A.A., Trenton Chapter | Electronic Data Processing and Operations Research for Top Executives |
| 19 | Kenneth J. Mutzel, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | Subchapter S Capitalization and Thin Corporations |
| 19 | James Neely, Jr., Boston | National Machine Accountants Assoc. Pine Tree State Chapter, Portland | Building Accounting Controls and Audit Trails into Data Process- ing Systems |
| 19 | Herman Stuetzer, Jr., Boston | University of Rhode Island Tax Institute | Personal or Business—Recent De- velopments re Deductible Ex- penses of the Employed and Self Employed |
| 20 | James P. Colleran, Cleveland | Toledo University Tax Institute | Subchapter S Corporations |
| 20 | Edward F. Habermehl, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | Panel Discussion—Pennsylvania Corporate Taxes and the Manu- facturer's Exemption |
| 20 | Ralph P. Kulzer, Pittsburgh | Tenth Annual Accounting Sym- posium, Duquesne University | Expansion of the Profession |
| 20 | Paul D. Yager, Washington | 13th Annual Tax Clinic, University of Alabama | Subchapter S—Blessing or Bane |
| 23 | H. O. Reyburn, Tulsa | Tulsa University | Specialized Practice—Taxation |
| 23 | Howard L. Swiger, Rockford | Rockford Board of Education class in small business management | Financial Planning for Small Business |
| 24 | Dr. Tibor Fabian, M. S. R. & C. D. | I.A.T.A., Miami, Florida | Case Studies in OR |
| 24 | J. Paul Finnegan, Herman Stuetzer, Jr., Boston | Massachusetts Society of C.P.A.s | Panel Discussion—Massachusetts Corporation Excise |

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|-------------|--|--|--|
| Nov. | | | |
| 24 | Jerome Y. Halperin, Detroit | Wayne State University Material Management Center | Taxation of Smaller Businesses |
| 24 | Felix Kaufman, M. S. R. & C. D. | I.A.T.A., Miami, Florida | Role of Computers in OR |
| 24 | George H. Kern, Chicago | Ravenswood Lions Club | When Your Tax Return is Examined |
| Dec. | | | |
| 1 | Raymond E. Graichen, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | The C.P.A. |
| 1 | George H. Kern, Chicago | Lawndale Lions Club | When Your Income Tax Return Is Examined |
| 2 | J. Paul Finnegan, Boston | Massachusetts Society of C.P.A.s | Panel Discussion—Estate Plan- ning Presentation |
| 2 | Philip J. Taylor, Philadelphia | LaSalle College | Careers in Public Accounting |
| 3 | Joseph J. Hyde, San Francisco | San Francisco Chamber of Com- merce and California Society of C.P.A.s, Income Tax Conference | Recent Changes in Federal Income Taxes—Legislation, Regula- tions, Court Decisions |
| 3 | Robert L. Jessee, San Francisco | San Francisco Chamber of Com- merce and California Society of C.P.A.s, Income Tax Conference | Corporate Tax Planning—Role of the Controller, C.P.A. and Attorney |
| 3 | Kenneth P. Johnson, Pittsburgh | Duquesne University | The Certified Public Accountant —Public Accounting and Man- agement Services |
| 3 | Philip J. Taylor, Philadelphia | Villanova University | Careers in Public Accounting |
| 3 | H. Martin Westfall, Pittsburgh | West Virginia University | Peculiarities in Auditing of Small Businesses |
| 4 | Eldin H. Glanz, Detroit | Michigan Association of C.P.A.s | Tax Highlights for 1959 |
| 4 | M. E. Richardson, New York | Second Annual Kentucky Institute on Federal Taxation | Professional Responsibility in Tax Practice |
| 4 | Joseph E. Tansill, Chicago | Illinois Society of C.P.A.s | State Taxation on Interstate Commerce |
| 4 | G. W. Welsch, Dallas | South Plains Trust and Estate Council | Role of the Accountant in the Ad- ministration of an Estate |
| 4 | Paul D. Yager, Washington | Second Annual Kentucky Institute on Federal Taxation | Corporations Taxed as Partner- ships; A Second Look |
| 7 | Dr. Tibor Fabian, Herman C. Heiser, Felix Kaufman, M. S. R. & C. D. | A.M.A., Los Angeles | E.D.P. for Top Executives—Mod- ern Aids to Decision Making |
| 8 | Raymond E. Graichen, Philadelphia | A.M.A., New York | Tax Consequences of Mergers Acquisitions |
| 8 | William B. Keast, Philadelphia | Pennsylvania Institute of C.P.A.s, Philadelphia Chapter | Career Opportunities in Accounting |
| 8 | Carlin P. Oliphant, St. Louis | Systems & Procedures Association, St. Louis Chapter | Panel Discussion—C.P.A. Looks at Systems |
| 8 | Philip J. Taylor, Philadelphia | Germantown High School | Careers in Public Accounting |
| 8 | Leo V. Tinkham, Chicago | Annual State Meeting of the As- sociated General Contractors of Illinois | Depreciation |

Speaking Engagements

| <i>Date</i> | <i>Speaker</i> | <i>Organization</i> | <i>Topic</i> |
|-------------|---------------------------------------|---|--|
| Dec. | | | |
| 9 | Paul D. Yager, Washington | American University Tax Institute, 1959, Washington | Recent Developments in Depreciation and Accounting Methods |
| 10 | C. H. Towns, New York | N.A.A., Hagerstown Chapter | Profit Analysis for Profit |
| 11 | J. Walker Voris, Los Angeles | California Society of C.P.A.s, San Francisco Chapter, Accounting Systems Conference | A Completely Integrated System Using an Interconnected Accounting Machine |
| 15 | Dr. Tibor Fabian, M. S. R. & C. D. | University of Pennsylvania | Inventory Management and OR |
| 15 | John J. Fox, Detroit | Systems and Procedures Association of America | Forms of the Future |
| 15 | Louis S. Sorbo, Louisville | N.A.A., Louisville Chapter | Panel Member—Tax Aspects of Fringe Benefits |
| 16 | Norman E. Auerbach, New York | New York State Society of C.P.A.s, Mid-Hudson Chapter | Pension Profit Sharing and Other Deferred Compensation Arrangements |
| 16 | Anthony P. Spagnol, Pittsburgh | Pennsylvania State University | Case Studies on Tax Effect Accounting |
| 16 | Robert S. Straith, Los Angeles | Systems and Procedures Association, San Fernando Valley Chapter | Panel Discussion—The Systems Survey |
| 17 | Maurice B. T. Davies, Los Angeles | N.A.A. Pomona Valley Chapter | Planning for the Reduction of Costs |
| 17 | G. W. Welsch, Dallas | N.A.A. Fort Worth Chapter | Current Income Tax Developments |
| 26 | Francis A. Gallagher, Rockford | Northern Illinois Chapter C.P.A.s, Northern Illinois Chapter C.L.U.s, Rockford Trust Officers, Winnebago County Bar Association | Panel Discussion—Trusts and Their Practical Application in Estate Planning |

Professional Society Assignments

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The following partners and members of our staff are serving as members of council or on committees for the year 1959-60:

Members of Council

Elected Members

| | |
|-----------------------------|---------------|
| Raymond G. Ankers | New York |
| Claude R. Giles | San Francisco |
| Mark C. Walker | Boston |
| Harry C. Zug | Philadelphia |

Member at Large

| | |
|----------------------------|--------------|
| George A. Hewitt | Philadelphia |
|----------------------------|--------------|

Ex-Officio—Past President

| | |
|-----------------------------|----------|
| Alvin R. Jennings | New York |
|-----------------------------|----------|

Trial Board

| | |
|----------------------------|--------------|
| George A. Hewitt | Philadelphia |
| Coleburke Lyons | Detroit |

Committees

| | |
|---|--------------------------------|
| Accounting Principles Board | Alvin R. Jennings, New York |
| Auditing Procedure | Philip L. Defliese, New York |
| Awards | Coleburke Lyons, Detroit |
| Bank Auditing | J. Edward Burke, New York |
| Bar (Relations With) | John C. Potter, Detroit |
| C.A.B. (Relations With) | R. Kirk Batzer, New York |
| Economics of Accounting Practice | Donald M. Russell |
| Editorial Advisory Board | J. Wesley Huss, San Francisco |
| Electronic Accounting | Herman C. Heiser, New York |
| Ethics (Professional) | H. O. Reyburn, Tulsa |
| Ethics of Tax Practice | George A. Hewitt, Philadelphia |
| Executive | Alvin R. Jennings, New York |
| Federal Taxation | |
| Subcommittee on Partnerships and Partners | Philip Bardes, New York |
| Subcommittee on Special Tax Problems | |
| (Chairman) | Herman Stuetzer, Jr., Boston |
| Subcommittee on Administration, Procedure and Miscellaneous Taxes | Paul D. Yager, Washington |
| Subcommittee on Estate Planning | Norman E. Auerbach, N. Y. |
| Insurance Accounting | Julian R. Maher, New York |
| International Congress (Planning Committee) | R. Kirk Batzer, New York |
| International Relations | James J. Mahon, New York |

Professional Society Assignments

Interstate Commerce Commission (Relations

| | |
|---|--------------------------------|
| With) | G. F. Schweitzer, Philadelphia |
| Labor Union and Welfare Funds | Price G. Righter, Philadelphia |
| Long-Range Tax Policy | Mark E. Richardson, New York |
| Meetings | Philip J. Taylor, Philadelphia |
| National Defense | William T. Barnes, Washington |
| Public Accountants (Cooperation With) | Claude R. Giles, San Francisco |
| Public Affairs | Harry C. Zug, Philadelphia |
| Public Housing (Accounting for) | Harold C. Chinlund, Baltimore |
| Public Utility (Chairman) | Walter R. Staub, New York |
| Securities Brokers and Dealers (Audits of) | |
| (Chairman) | George E. Doty, New York |
| Staff Accountants | Alfred J. Krupka, New York |
| Statistical Sampling (Chairman) | Thomas J. Cogan, New York |
| Surety Companies (Cooperation With) | Louis C. Moscarello, New York |
| Trade Associations (Cooperation With) | J. Wesley Huss, San Francisco |
| Uniform Accounting Provisions of State Cor- | |
| poration Laws | Carl J. Simon, New York |
| U. S. Chamber of Commerce | Thomas J. Snowden, St. Louis |

Committees on Membership

| | |
|----------------------------|---------------------------------|
| Policy Committee | Robert L. Starks, Cleveland |
| Illinois | Lawrence E. Frazee, Rockford |
| Maryland | John A. Engel, Jr., Baltimore |
| Ohio | Katherine E. Pfeifer, Cleveland |

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Notes

INTERNATIONAL FIRM

Correspondence to the Milan Office should be addressed as follows:

Coopers & Lybrand A. G.
Represented by
Fidital-Istituto Fiduciario Italiano S.p.A.
Corso Vittorio Emanuele 7/1
Milan, Italy

The new address of the Rotterdam Office is:

Coolsingel 6
Rotterdam 1

Mr. Walter L. Schaffer is currently visiting the African offices of Coopers & Lybrand.

BIRMINGHAM

Mr. Frank H. Gafford has been admitted to membership in the A.I.C.P.A.

Messrs. J. Richard Norton and Jimmy R. Shelby recently passed the C.P.A. examination.

BOSTON

Mr. J. Paul Finnegan served as Chairman of a Tax Dinner meeting of the Massachusetts Society of C.P.A.'s at the University Club on November 16.

Mr. Robert S. Lappin has passed the C.P.A. examination.

Mr. Roderick K. Macleod represented the Office at the South Shore National Bank seminars on data processing at the Quincy Neighborhood Club.

Mrs. Marion E. Matheson became a member of the Quarter Century Club of the Firm in December and was presented with a gold watch at the Quarter Century Club Luncheon.

CHICAGO

Mr. William R. Hindman has been transferred from Louisville to the Management Services Department of the Chicago Office. Effective April 1, he will assume the duties of Assistant Regional Director of the Central Region, Management Services.

Mr. Murphy has been appointed a member of the Federal Revenue and Expenditures Committee, and the Governmental Affairs Advisory Committee, of the Chicago Association of Commerce and Industry for 1959-1960.

Mr. Tansill has been appointed a member of the Committee on State and Local Taxation of the Illinois State Chamber of Commerce for 1959-1960.

Mr. Tinkham has been appointed a member of the Federal Taxation Committee of the Illinois State Chamber of Commerce for 1959-1960.

We report with deep regret the death of Miss Marion E. Ayres.

Messrs. Gene Baroni, Edward J. Smith and Carlyle C. Wulff, Jr. passed the November C.P.A. examination.

CINCINNATI

Mr. Charles F. Meier successfully completed the November C.P.A. examination.

CLEVELAND

Mr. A. N. Volpe has been awarded a C.P.A. certificate and Mr. William C. Winold successfully completed the November C.P.A. examination.

The Cleveland Partners are sponsoring a Junior Achievement Company.

DALLAS

Mr. Arthur has been appointed to the Board of Governors of the Brook Hollow Golf Club for 1960-1961, and is Chairman of the Fiscal Committee for 1960. He is also Team Captain for 1960 of the Park Cities Y.M.C.A. Sustaining Membership Drive.

Mr. J. M. Conder is Secretary and a member of the Board of Trustees of the Zion Lutheran Church.

Mr. Welsch is serving on the Committee on Citizenship and Government of the North Dallas Chamber of Commerce.

DETROIT

Mr. W. Sturgis Corbett has been transferred from New York to the audit staff of the Detroit Office.

Mr. Frank R. Gilsdorf has been appointed Editor of *The Catholic Accountant*, the monthly publication of the Catholic Accountants' Guild.

Mr. John J. O'Donnell, Jr. has been transferred from New York to the Management Services Department of the Detroit Office. Effective April 1, he will assume the duties of the Regional Director of the Central Region, Management Services.

The following members of the Detroit Office staff have successfully completed the C.P.A. examination:

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Lawrence R. Doyle
Ronald Hamburger

Vincent J. Lico
David Mandell

Warren G. Wintrub

Messrs. Melvin Dutcher, James M. Guertin and Robert E. Wenner have completed requirements for the Certificate of Examination.

HARTFORD

Messrs. Donald R. Handville and Stanley N. Roseberry, Jr. have become members of the National Association of Accountants.

Mr. Robert J. Smith has become a member of the Junior Chamber of Commerce of Torrington, Connecticut.

LOS ANGELES

Mr. Robert J. Borgmann is serving as Budget Officer of the Air Force Reserve, 452nd Troop Carrier Wing, Long Beach, Calif.

Mr. Edwin B. Cassidy has been appointed a member of the Capital Projects Appeal Board of the County of Los Angeles. The function of the Board is to arbitrate differences of opinion between contractors and the County.

Mr. Sherman L. Harper has been appointed a member of the Downtown Technical Discussion Group of the Los Angeles Chapter of the California Society of C.P.A.s for 1959-1960.

Miss Madonna E. Newburg has become a member of the Los Angeles Chapter of the California Society of C.P.A.s.

Mr. Gerald Roshwald has become a member of the Los Angeles Chapter of the California Society of C.P.A.s.

The following members of the Los Angeles Office have successfully completed the C.P.A. examination:

Manuel J. Armendariz
Albert D. Brown
Carl M. Moser

Edward R. Pasini
Gerald R. Perlstein
Paul Pike

Pat Rossi, Jr.

We report with deep regret the death of Mr. Albert Waxman.

NEW YORK

Mr. Campbell is now serving as Treasurer of the Phelps Memorial Hospital, North Tarrytown, N. Y.

Mr. Carson is Chairman of the New York University Alumni Fund.

Mr. Jennings has been appointed a member of the 30 Broad Street Advisory Board of the Chemical Bank New York Trust

Company, and is also on the Bank's Finance Committee of the Committee for Economic Development.

Mr. Moscarello has become a member of the Metropolitan Controllers Association. He is also a member of the Advisory Committee to the Standardization Committee of the Controllers Congress of National Retail Merchants Association.

Mr. Frank P. Smith has been appointed a consultant to the A.I.C.P.A. Committee on Relations with Universities, and a member of the A.A.A. Committee to Study the Ford and Carnegie Foundation Reports.

Mr. Sidney A. Stahlschmidt retired on December 31, 1959, after 42 years of service with the Firm. He was honored with luncheons given by partners and by associates of many years. We all wish Sid a long and happy retirement.

Mr. Warren G. Wintrub has been transferred from Detroit to the Tax Department of the New York Office.

PHILADELPHIA

Mr. Burd has been reappointed a member of the Board of Trustees of Rider College for a three-year term.

Mr. Leon Daniels has been elected Treasurer of the Llanerch Country Club, Llanerch, Pa.

Mr. Graichen is Chairman of the Audit Committee of the Board of Trustees of Wayne Presbyterian Church, Wayne, Pa. He has also been elected to membership in the Seaview Country Club, Absecon, N. J.

Mr. Harold G. Hunsberger has been elected Treasurer of the Lower Gwynedd Township School District, Springhouse, Pa., for 1959-1960.

Mr. William B. Keast has been elected Treasurer of the Aronimink Golf Club of Newton Square, Pa.

Mr. Meredith has been elected a member of Alpha Phi Chapter of Beta Alpha Psi, Temple University.

Mr. Mullen is serving as Division Chairman of the Cardinal's Committee of the Laity—1960 Catholic Charities Appeal.

We report with deep regret the death of James E. Witman, a valued member of our accounting staff for twenty-six years.

The following members of the Philadelphia staff have passed the C.P.A. examination:

Jerome J. Lane

Joseph V. O'Donnell

James C. Meehan

Raymond C. Terry

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PITTSBURGH

The following members of the Pittsburgh staff have passed the C.P.A. examination:

Walter J. Joyce
Jerry D. Sullivan

Mr. James E. Montgomery is to receive an engraved certificate for being one of the two individuals who attained the highest grades in the May, 1959 C.P.A. examination. The award will be presented at the annual meeting of the Pennsylvania Institute.

PORTLAND

Mr. Robert L. Bergner has passed the C.P.A. examination.

ROCKFORD

Various members of the Rockford Office are serving on Committees of the Rockford Chamber of Commerce as follows:

| | |
|--------------------------------|---------------------------|
| Board of Directors | Lawrence E. Frazee |
| Finance | Robert W. Myers, Chairman |
| Membership | Robert W. Myers |
| National Affairs | Robert W. Myers |
| | Edward J. Rudnicki |
| Social Security & Unemployment | |
| Compensation | J. Warren Rowland |
| Taxation | { Lawrence E. Frazee |
| | { Francis A. Gallagher |
| | { Burton E. Lindgren |

Mr. Rowland is also serving on the Finance Committee and Pancake Day Committee of the Kiwanis Club of Rockford.

Mr. Donald C. Messner has completed the requirements for the C.P.A. certificate.

TULSA

Mr. Reyburn has been appointed Chairman of the Program Committee of the Oklahoma State Society annual meeting in June. He has also been appointed a member of the Panel of Institute Speakers by the A.I.C.P.A.

The following members of the Tulsa staff have passed the C.P.A. examination:

Don R. Freeman
Jack A. Sharp, Jr.

Coopers & Lybrand

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Gwelo
Kitwe
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Arusha
Dar Es Salaam
Jinja
Kampala
Mombasa
Moshi
Mwanza
Nairobi

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Cape Town
Durban
East London
Johannesburg
Port Elizabeth
Vanderbijlpark
Virginia
Windhoek

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Accra
Lagos

BELGIAN CONGO

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Auckland
Christchurch
Dunedin
Palmerston North
Wellington

Lybrand, Ross Bros. & Montgomery

Offices

| <i>Cities</i> | <i>Addresses</i> |
|---------------------------|------------------------------|
| BALTIMORE 2 | First National Bank Building |
| BIRMINGHAM 3 | First National Building |
| BOSTON 10 | 80 Federal Street |
| CHICAGO 4 | Board of Trade Building |
| CINCINNATI 2 | Carew Tower |
| CLEVELAND 14 | Union Commerce Building |
| DALLAS 2 | First National Bank Building |
| DETROIT 26 | Book Building |
| HARTFORD 3 | 37 Lewis Street |
| HOUSTON 2 | 1114 Texas Avenue |
| LOS ANGELES 13 | 510 South Spring Street |
| LOUISVILLE 2 | Heyburn Building |
| NEW YORK 4 | Two Broadway |
| PHILADELPHIA 2 | Packard Building |
| PITTSBURGH 22 | Oliver Building |
| PORTLAND 4 | Executive Building |
| ROCKFORD | 119 North Church Street |
| SAINT LOUIS 1 | 411 North Seventh Street |
| SAN FRANCISCO 4 | 100 Bush Street |
| SEATTLE 1 | Skinner Building |
| TULSA 3 | Philtower Building |
| WASHINGTON 5 | Investment Building |

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 WILLIS K. WATERFIELD . . . Cincinnati
 GODFREY W. WELSCH . . . Dallas
 PAUL M. WHITMAN . . . Cincinnati
 PAUL D. YAGER . . . Washington
 HARRY C. ZUG . . . Philadelphia



